S. Hrg. 99-633

AVAILABILITY AND COST OF LIABILITY INSURANCE

HEARING

BEFORE THE

COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION UNITED STATES SENATE

NINETY-NINTH CONGRESS

SECOND SESSION

ON

AVAILABILITY AND COST OF LIABILITY INSURANCE

FEBRUARY 19 AND MARCH 4, 1986

Printed for the use of the
Committee on Commerce, Science, and Transportation

U.S. GOVERNMENT PRINTING OFFICE
59-685 O WASHINGTON : 1986

For sale by the Superintendent of Documents, Congressional Sales Office
U.S. Government Printing Office, Washington, DC 20402

5261-36

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AVAILABILITY AND COST OF LIABILITY INSURANCE

WEDNESDAY, FEBRUARY 19, 1986

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC.

The committee met, pursuant to notice, at 9:33 a.m., in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the committee) presiding.

Staff members assigned to these hearings: David Zorensky, staff counsel and Amy Bondurant, minority staff counsel.

OPENING STATEMENT BY THE CHAIRMAN

The CHAIRMAN. I want to start by reading a statement, and I want to apologize for the length of it, but it sets out what I think is the problem and where we are heading in this committee.

Good morning. Today the Commerce Committee begins the first of 2 days of hearings on one of the most serious problems the country faces today—the increasing scarcity and rising cost of liability insurance. This is an issue of critical concern to the committee not only because of the impact the insurance crisis is having upon specific industries within our jurisdiction—Commerce subcommittees have already heard about this problem from truckers, fishermen, bus companies, and the commercial satellite industry—but also because of the widespread impact it is having upon other types of businesses, as well as professionals and local governments.

Although its role is not often as visible as it is today, the existence of affordable and readily available liability insurance is vital to the operation of our economy. Without it, consumers pay higher prices for essential goods and services; professionals such as doctors, engineers, accountants, and architects may not be able to provide us with their important skills; jobs are lost as companies are forced to go out of business; taxes go up as local governments are forced to pay higher premiums for their municipal liability insurance; product innovation and technological development is discouraged, weakening America's position in foreign trade; and persons with legitimate personal injury claims may go uncompensated because culpable parties are uninsured.

In my own State of Missouri, the problem has manifested itself in a number of different ways:

The cost of insurance coverage for the north Kansas City School District rose 296 percent in 1 year;

Southwestern Bell Telephone Co. saw its bill for excess liability or umbrella coverage triple;

In St. Joseph, MO, local officials were forced to shut down the bus system for 8 days last month because its insurer went bankrupt, leaving many Christmas shoppers stranded without transportation;

At least 15 county jails in Missouri had to close for a period of time last year because liability insurance could not be found at any cost;

A St. Louis manufacturer with $3 billion in sales had its liability insurance premium quadruple;

Medical malpractice insurance premiums for family practice physicians in Missouri more than doubled between 1984 and 1985, and excess limits coverage for hospitals in Jackson County dried up completely;

Even the State's lawyers are in trouble—the Missouri bar recently lost its professional liability insurance coverage and had to set up a mutual company of its own to write policies for its members.

Because of the urgency of the problem and its important implications for all Americans, Members of Congress are deeply interested in finding solutions to the insurance crisis; however, each of us comes at the problem with a slightly different mindset. Some of us are more willing to blame the tort system; others are more critical of insurance industry practices and performance.

My own views have been stated previously, before this committee and elsewhere. It is evident that the most direct and immediate cause of the shortages and price hikes that plague liability insurance buyers today is the unusually severe, cyclical downturn in the insurance market. The extent to which this market cycle may have been exacerbated by faulty underwriting and pricing decisions of insurers is a question we will explore today. However, regardless of the short-term market forces affecting the industry, it seems to me that the cost and availability of insurance has been significantly affected by the cost and unpredictability of the civil justice system. I, therefore, believe that one of the most important actions we can take as a committee is to give our approval to Federal product liability reform legislation.

I believe that the basic elements of a workable compromise on product liability reform are now embodied in S. 1999, the Product Liability Voluntary Claims and Uniform Standards Act, which combines uniform Federal product liability standards with an alternative claim system for expedited recovery of net economic loss by those injured by defective products. More work needs to be done on this proposal, but hearings will be held on S. 1999 later this month and it is my hope that after reviewing the testimony from these hearings the committee will be able to move ahead expeditiously to act on this legislation.

In addition, Senator Kasten and I have instructed the committee staff to draft another piece of legislation that I believe can provide some help to those affected by the current crisis in liability insurance. This proposal would amend the Product Liability Risk Retention Act of 1981 to make it easier for businesses, individuals, and organizations to purchase general liability coverage collectively and to self-insure against general liability risks by joining together in risk retention groups. In view of the significant capacity shortage in the commercial insurance market, it is essential that we do everything that we can to help purchasers of insurance to help themselves. A number of other members of the committee have expressed interest in expansion of the Risk Retention Act, and I encourage them to join Senator Kasten and me in cosponsoring this legislation, which we hope to introduce later this week.

I am aware that neither of these measures provides a complete answer to the problems we face today. The factors affecting insurance cost and availability are numerous and complex. For that reason, these hearings have been structured to investigate the liability insurance crisis in an orderly and thorough manner.

During today's hearing, we will attempt to learn as much as we can about the business of insurance—how the industry operates and why the market for liability insurance tends to be cyclical. We will examine the role of reinsurance, the financial condition of the industry, and the prospects for improvement. To help us in this effort, we will hear from representatives of the insurance industry, as well as from other persons with knowledge about the operation of the property-casualty industry, including analysts, brokers, agents, and others concerned about the performance of the industry.

On the second day of full committee hearings, scheduled for March 4, we will examine in greater detail a number of proposed solutions to the current crisis, both at the State and Federal level, including tort reform, greater Federal involvement in regulation and reinsurance, and expanded risk retention and self-insurance opportunities. It is my hope that with the information we obtain from these hearings we will be able to formulate the appropriate action for Congress to take in response to the current crisis.

I apologize for the length of that statement. Senator Long, do you have any comments?

OPENING STATEMENT BY SENATOR LONG

Senator LONG. Senator, I want to congratulate you on providing leadership to move forward with legislation in this area. I know of no area that is more deserving and really requires the attention of Congress more than this one. It is an area where a citizen at this time cannot agree on the answer, but we must find them and we must find a way to bring Senators together, because here are some very pressing problems that cry out for solutions, and I believe you are very fortunate as Chairman of this Committee to have seen this, and you are giving your attention to it in this context.

The CHAIRMAN. Thank you very much. Senator Gore?

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Mr. Chairman, I, too, want to commend your decision to hold 2 days of hearings on this important issue of the cost and availability of liability insurance. Hearings last December before the Business Trade and Tourism Subcommittee chaired by the Senator from South Dakota, Mr. Pressler, of which I am a member, made clear the need for a comprehensive examination of the skyrocketing cost, and unavailability of liability insurance and certain important lines of property and casualty insurance.

In Tennessee and across the country, businesses, professionals, and local governments simply cannot obtain insurance, or if they can find it, the cost is prohibitive. The Senate Small Business Committee held field hearings in Tennessee chaired by my senior colleague from Tennessee, Senator Jim Sasser.

These hearings highlighted the devastating impact of soaring rates and shortages among businesses that are too small to absorb rate increases of several hundred percent and for whom unavailability of insurance may well mean closing their doors.

At recent open meetings throughout Tennessee I have had the experience of coming prepared for questions on the deficit, on Gramm-Rudman and taxes, only to face repeated questions on what can be done about the insurance crisis. Is the word "crisis" appropriate? I believe it is, because there is a crisis in the cost and availability of property casualty insurance. That there is a crisis may be the only thing upon which people testifying here today can agree.

Unfortunately, however, we need more than a consensus that serious problems exist. We need to address these problems. Yet before we undertake to change existing Federal statutes regarding insurance or enact far-reaching changes in existing civil law, we must make sure that this action is justified by the depth of the current crisis.

We should act only after we have a clear understanding of how the insurance industry works. That is the critical focus of these hearings. How and why are the decisions made in the industry to raise rates and withdraw from certain lines. Once we have a full understanding of this, we can proceed to examine ways the current problems with the industry can be remedied, keeping in mind that the easy answers or the most apparent ones are sometimes simply wrong.

I appreciate the witness's efforts to help us understand the depth of the current crisis, and I look forward to studying the testimony presented today.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Pressler.

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. Thank you, Mr. Chairman.

Let me echo what has been said, and congratulate the Chairman for taking such a strong leadership role in this area. Let me say, as I see it, there are really two sides squabbling over this issue, the trial lawyers and the consumer groups in the one corner and the insurance industry on the other, and up to this point I have not been too happy with either.

The truly injured party, the insurance consumer, is being hurt. Let me explain my frustration with these two groups. We may well have another day of listening to horror stories about how high insurance rates are, and indeed that has been well established, but we must try to come to grips with the need for solid, empirical, and objective information. Then maybe we can find a solution.

Two of the main groups we will hear from today are the insurance industry and the so-called consumer groups which are aligned with the trial lawyers. The insurance industry is advocating tort reform as the primary means to correct the problem. The consumer groups or the trial lawyers say the tort laws are not the cause of the problem, and are urging a stronger Federal role to curb what they say are the abuses of the insurance industry.

I have spent much time listening to both sides, and I must say that up to this point I have been very disappointed in what I have heard and, more importantly, what I have not heard thus far. Once you get through the rhetoric and horror stories coming from both sides, there is precious little solid evidence from either side to support their arguments as to the cause of the problem. There is clear evidence from businesses and other insurance buyers that we are indeed in the midst of an insurance crisis, but we have not been able to get beyond the finger pointing stage as to the real causes of or the cures for the problem.

If the so-called consumer groups, or maybe more accurately the trial lawyers, from whom we are not hearing directly today, are advocating federal involvement in insurance regulation or some other alternative to tort reform, the burden is on them to present hard evidence of the insurance industry's unfair rate setting practices or conspiracies designed to "blackmail" legislatures into tort reform.

Other than accusations made in the press, they have offered no real proof that any of this exists. I have always had a hard time understanding why some of these so-called consumer groups have failed to participate in a meaningful way in the efforts to reduce the high cost resulting from a civil justice system out of control.

These costs are paid by the consumer in the form of higher prices, and the fact of the matter is that the lawyers rather than the injured parties get most of the money associated with litigation costs. The insurance industry, on the other hand, has not provided us any serious empirical evidence which connects the increasing costs of insurance to the tort laws of the individual states. They have been unable to provide us with a causal link.

Again, if they are going to urge change in this area, the burden is on them to show this very fundamental connection. At the December 3 hearing in this room, I submitted a number of questions along this line to both the insurance industry and consumer groups. I was very disappointed in the answers. I am going to resubmit some of those questions today, and I am hoping for better results.

If tort law is the problem, why are States with relatively conservative laws suffering rate increases of the same magnitude as those with laws the industry would term as too liberal. I have often made the point that under the current ratemaking system, States such as South Dakota are paying for the sins of the New Jerseys and Californias of the world. If this is the case, how would tort reform lower insurance costs when those States that do have good tort laws are no better off than the others?

Why cannot the insurance industry show us the percentage of claims incurred as a result of court awards as opposed to uncontested payments? That is certainly something that should be available in an industry that keeps such good records. If they do not keep the kind of records necessary to answer these fundamental questions, how can they blame the civil justice system?

These are the kinds of questions I want to see answered, and I will keep pressing for the answers.

I make these comments as a friend of the insurance industry. Frankly, I do believe that tort reform is needed, but if the industry is serious about this effort, it is going to have to prove its case. I hope that it will, because I believe it is important to curtail some of the excesses of our civil justice system and provide some real relief to the insurance buyers and true consumers we are here to represent.

Mr. Chairman, I ask unanimous consent to insert my full statement in the record.

[The statement follows:]

STATEMENT OF SENATOR PRESSLER

The problems associated with the high cost and scarcity of liability insurance continue—both in my home state of South Dakota and across the country. Every day we read news reports of another business, or local government, or group of professionals unable to obtain adequate and affordable liability insurance coverage. And costs for the products and services supplied by the affected groups continue to be passed on to the consumer in the form of higher prices.

I congratulate the distinguished Chairman for holding these important hearings, and look forward to working closely with him in an effort to develop solutions to this problem. A number of initiatives are already beginning to take shape at the State and Federal level, but we are still far from reaching any comprehensive solution to this enormous and complex problem.

State insurance commissioners are implementing measures to prevent mid-term cancellations and policy non-renewals without cause. According to the National Conference of State Legislatures, State assemblies are considering over 1300 bills designed to alleviate availability and affordability problems, and correct some of the excesses of our civil justice system.

Here in Congress similar preliminary steps are being taken. In addition to this series of Commerce Committee hearings, the Small Business Committee has held a series of field hearings—two of which I chaired in South Dakota—and will be holding Full Committee hearings here in Washington tomorrow and Friday in which I will participate. We have a new proposal for much needed product liability reform which this committee will consider later this month, as well as language to amend and expand the 1981 Risk Retention Act. There is also a proposal, of which I am a cosponsor, which encourages States to reform their medical malpractice rules. Finally, I understand there are proposals to repeal the McCarran-Ferguson Act of 1945 and involve the Federal Government in the business of regulating the insurance industry.

My general position on this issue is fairly clear, I believe. The insurance problem is the number one consumer issue of the decade, and I agree with the Chairman that it is probably the most important issue before this Committee in the 99th Congress. For the record [1] I would like to ask unanimous consent that an article I wrote which appeared in yesterday's "Journal of Commerce," entitled "Liability Cover: Consumer Issue of the 1980's," be inserted in the record immediately following my opening remarks. It addresses many of the issues I want to touch upon later today.

I have consistently supported product liability reform. There is a pressing need to take steps to control the costs and increase the availability of this and the other lines of commercial liability insurance. I have also supported efforts to further facilitate the formation of expanded risk retention groups. I might add that I am considering, and indeed am in the process of drafting tort reform proposals.

The point is that there are literally dozens of initiatives floating around today which are designed to address this very complex problem. There are also dozens of interest groups involved in the debate, all pushing their own proposal with their own axe to grind.

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[1] See "Journal of Commerce," Feb. 18, 1986, p. 13A.

There are really two sides squabbling over this issue: the trial lawyers and consumer groups on one and the insurance industry on the other. Up to this point, I have not been too happy with either. And the truly injured parties—the insurance buyers and the real consumers—are being hurt while everyone else is pointing fingers.

Two of the main groups we will hear from today are the insurance industry and the so-called "consumer groups." The insurance industry is advocating tort reform as the primary means to correct the problem. The consumer groups say the tort laws are not the cause of the problem and are urging a stronger Federal role to curb what they call the "abuses" of the insurance industry.

I have spent much time listening to both sides, and must say that up to this point I have been very disappointed in what I have, or more importantly, have not heard thus far. Once you get through the rhetoric and horror stories coming from both sides, there is precious little solid evidence on either side to support their arguments as to the cause of the problem. There is clear evidence from businesses and other insurance buyers that we are indeed in the midst of an insurance crisis, but we have not been able to get beyond the finger pointing stage as to the real causes of or cures for the problem.

If the so-called consumer groups—or maybe more accurately the trial lawyers from whom we are not hearing directly today—are advocating Federal involvement in insurance regulation or some other alternative to tort reform, the burden is on them to present hard evidence of the insurance industry's unfair rate setting practices or "conspiracies" designed to "blackmail" legislatures into tort reform. Other than accusations made in the press, they have offered no real proof that this exists.

I noted with interest a recent "Journal of Commerce" article in which one of today's witnesses uses the Canadian experience with tort reform to argue that reform efforts in the United States would not alleviate our liability insurance problem. I will explore this in a little more detail later in the hearing, but I think it is worth pointing out here that we have done a little comparative study of our own, using the European and Japanese experiences as examples, and have found quite different results. The legal systems and rules in those countries do indeed represent what we would consider sweeping tort reforms if they were enacted in this country.

A few examples will illustrate my point:

Punitive damages.—The concept of punitive damages in civil suits, especially in product liability cases, is virtually unheard of in Japan and very rare in Europe.

Pain and suffering damages.—Damage awards for pain and suffering are seldom awarded in either Europe or Japan. When they are, the amounts awarded tend to be substantially less than those in the United States. Indeed, they are limited by statute in some cases.

Collateral source rule.—For personal injury and products liability claims, other countries generally require damage awards to be offset by the amount of compensation the plaintiff receives from other sources such as worker's compensation or insurance payments.

Uniformity.—In most civil law countries, these types of laws are uniform throughout the country. Indeed, the EEC's recent products liability directive mandates uniform standards on a supra-national level. In the United States we have 51 jurisdictions with 51 different rules, and most manufacturers can be haled into any jurisdiction.

Juries.—With a single exception, neither European countries nor Japan allows juries to set damage amounts in the types of cases we are discussing today. And with very few exceptions, the entire case is tried by a judge without any jury involvement whatsoever. The single European country still using juries to determine most civil damage awards is Ireland. The results in those cases are illustrative. Even though the standard of living is significantly lower in Ireland than in England, awards in tort cases are generally four to six times higher than those in England.

Contingent fees.—The existence of contingent fees is often cited as the single largest reason for the increasing number of personal injury and products liability claims in this country. Contingent fees are illegal in most developed countries other than the United States.

Discovery rules.—Outside the United States, pretrial discovery is much more limited—particularly in civil suits. The expense and alleged abuses associated with exercising these uniquely American attorney powers are often cited as reasons manufacturers and others are willing to settle out of court for what seem to be "frivolous" suits that could not prevail, even under the current American tort systems.

Frivolous suits.—Most countries impose substantial penalties on plaintiffs who bring frivolous lawsuits. Such is not the case in the United States. In fact, many critics have said that the U.S. system actually encourages lawsuits—frivolous or otherwise. Although there has been some effort in this area in recent years, we have yet to see any reforms with real "teeth."

These are a few examples of how our laws and rules differ from those of most other major economic powers of the free world. I am not proposing we adopt them in toto, but I do think there is a point here. There is no insurance crisis in these countries. And it is interesting that many experts in those countries ascribe our current problems predominantly to our tort system. I am not saying that we should adopt sweeping tort law changes to mirror the European or Japanese example. Indeed, I doubt very seriously whether our highly developed sense of individual rights and due process could or should accept changes of this sort. But I do believe we can learn from their experience, and I also believe we might be able to tailor some variations of the European or Japanese examples to address the problems we are facing in this country.

Another point this illustrates is that, applying the analysis relied upon in the "Journal of Commerce" article, the overwhelming evidence points to true tort reform as an effective means to alleviate the insurance problem.

I have always had a hard time understanding why some of these so-called consumer groups have failed to participate in a meaningful way in the efforts to reduce the high costs resulting from a civil justice system out of control. These costs are paid by the consumer in the form of higher prices, and the fact of the matter is that the lawyers, rather than the injured parties, get most of the money associated with litigation costs.

The insurance industry, on the other hand, has not provided us any serious empirical evidence which connects the increasing costs of insurance to the tort laws of the individual States. They have been unable to provide us with the casual link. Again, if they are going to urge change in this area, the burden is on them to show this very fundamental connection. At the December 3 hearing in this room I submitted a number of questions along this line to both the insurance industry and consumer groups. I was very disappointed in the answers. I am going to resubmit some of those questions today, and am hoping for better results.

If tort law is the problem, why are States with relatively conservative laws suffering rate increases of the same magnitude as those with laws the industry would term as too liberal? I have often made the point that under the current ratemaking system States like South Dakota are paying for the sins of the New Jersey's and California's of the world. If this is the case, how would tort reform lower insurance costs when those States that do have "good" tort laws are no better off than the others? Why cannot the insurance industry show us the percentage of claims incurred as a result of court awards, as opposed to uncontested payments? If they do not keep the kind of records necessary to answer these fundamental questions, how can they blame the civil justice system? These are the kinds of questions I want to see answered, and I will keep pressing for the answers.

I make these comments as a friend of the insurance industry. Frankly, I do believe that tort reform is needed. But if the industry is serious about this effort, it is going to have to prove its case. I hope that it will because I believe it is important to curtail come of the excesses of our civil justice system, and provide some real relief to the insurance buyers and true consumers we are here to represent.

The CHAIRMAN. Senator Trible.

OPENING STATEMENT BY SENATOR TRIBLE

Senator TRIBLE. Mr. Chairman, let me add to what has been said by saying that business people large and small are finding that insurance costs are escalating out of sight, and that often insurance protection is simply unavailable. I am surprised, much like my colleague from Tennessee, how often the subject is now being raised, at town meetings and other sessions I am having with my constituents.

When we are prepared to talk about other issues, people are bringing to our attention the insurance crisis that they face in their business lives.

So I think there is some momentum building for what we are about. The important thing is that we receive the kind of broad-based testimony on which we can base appropriate action, and that is what we are about today, and I commend you for your leadership.

The CHAIRMAN. Senator Hollings.

OPENING STATEMENT BY SENATOR HOLLINGS

Senator HOLLINGS. Thank you, Mr. Chairman.

Today, the Committee will examine an issue which poses a severe economic threat to the Nation's commerce—the volatility of the liability insurance market.

Recently, we've heard a great deal about the serious consequences of high insurance rates (or the unavailability of insurance) on a variety of interests—local governments, members of the medical profession, product manufacturers, and owners of commercial fishing vessels, to name a few. Since going without insurance is not a real option in today's society, the problem has produced an atmosphere of crisis.

Several of our Commerce subcommittees have already received testimony in select areas of this critical issue. I look forward to these hearings by the full Committee as we attempt to gain a more comprehensive understanding of this situation and its causes.

I believe almost all witnesses will agree that underpricing of premiums has contributed to the current situation. I will be especially interested to hear what steps, if any, industry witnesses believe state regulators should have taken to help to avoid the dramatic swings of the property-casualty insurance market. I am also curious as to the effect of lack of State regulation of the foreign reinsurance market and will look forward to the testimony of the witnesses, today, on this issue.

Some of the witnesses today will speak to the financial conditions and practices of the insurance industry. I am interested in hearing of their predictions of the industry's health in the next few years. I understand that there are now early signs that the availability crisis is easing and that additional capital is beginning to flow back into the reinsurance market.

The insurance crisis is a complex situation and proposed solutions are controversial. I hope that these hearings will be of benefit as we study the impact of the situation on commerce and consumers as well as possible remedies.

I have a statement from Senator Rockefeller that he would like to include in the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR ROCKEFELLER

Mr. Chairman, I am pleased that you have called two days of hearings to investigate a problem that has grown to a national crisis: the spiralling cost and extreme scarcity of commercial liability insurance.

Several of the witnesses appearing this morning testified before the Business Subcommittee in December. Since that hearing Congress's concern—judging by the quantity of hearings planned—has multiplied. For this week alone, today's hearing is only one of three on insurance—the House Energy and Commerce Committee and the Senate Small Business Committee are also focussing on this issue.

National organizations also are moving this issue up to the top of their legislative agendas. In January, I talked to the U.S. Conference of Mayors and the Consumer Federation of America about the insurance crisis.

In my own state of West Virginia, the situation becomes even more immediate and more desperate. For the better part of a year, West Virginia has been mired in one liability crisis after another—particularly in the municipal insurance area.

The latest occurred in Raleigh County, West Virginia which had its liability insurance policy terminated at the beginning of this year. Raleigh County commissioners, fearing personal liability, transferred all the county's prisoners to another jail and released nine inmates; shut down 11 county agencies and two parks; and blockaded all but one door to the county courthouse. Two weeks later the county commissioners signed an agreement with a Turkish insurance company, the only company that would answer their plea for coverage!

The municipal insurance crisis is a particularly chilling one because it is the public that will ultimately pay the price if towns and counties are forced to go without coverage. I wonder how many mayors, how many county commissioners, how many park and recreation officials and how many police chiefs will be willing to serve out their terms, if their community loses its insurance or becomes severely underinsured? Not many, I fear.

Local government is not alone in its insurance problems. I am sure that each of you have your own horror stories to tell—whether it concerns insurance for cities and towns, businesses, or professionals.

Despite the mounting interest being demonstrated by the Congress in this issue, there will be no "quick-fix" solutions to the insurance crisis. Congress's hearings will be useful to help focus attention on the magnitude, urgency, and breadth of this insurance crisis. Where we go from here, however, is harder to determine.

Since the McCarran-Ferguson Act of 1945 gives regulatory authority over the insurance industry to the states, it is unclear what Congress's role should be in this crisis. I would rather not create another federal bureaucracy for insurance. Yet recently, there have been calls from unlikely places, including some state insurance commissioners, for federal regulation of this industry. I expect that pressure for federal regulation will mount unless the crisis abates.

The strongest push at both the state and the federal level has been for tort reform. The insurance industry claims that the lion's share of the insurance problems stems from a civil liability system run amuck. Tort reform, it is claimed, will be the key to affordable and available insurance. Consumer groups disagree. They contend it's not our tort system, but rather poor underwriting practices and overreaction by the industry, that have caused the problem.

I agree that tort reform is one of several possibilities we should look to in order to ease this insurance crisis. Before we enact any tort reform legislation, however, we need an answer to this very important question: to what extent would this measure actually result in increased availability and reduced rates of insurance?

Tort reform should not be the only solution that the Committee examines. I believe—and I hope that the rest of this Committee agrees—that the insurance industry merits the same degree of scrutiny as does the court system. For instance, I think we need to look at whether the insurance industry should continue to be exempt from the federal antitrust laws.

Currently, I am studying a proposal, along with other Members of this Committee, to help businesses, municipalities, and other types of insurance consumers by expanding the Product Liability Risk Retention Act of 1981. Expansion of this Act would give consumers two options. First, cities and towns could form insurance pools to insure themselves. Second, several municipalities could join together and purchase insurance on a group basis. Several states still have laws prohibiting group insurance—this proposal would give purchasers another avenue to obtain insurance coverage. I welcome the advice and opinions of the witnesses on this idea.

Over the next few months, we in Congress have a responsibility to work hand-in-hand with local and state governments to come up with some answers to the insurance situation.

Some of the questions we need to look at include:

What reforms would most likely result in more affordable and accessible property/casualty insurance?

Should the federal government get into the insurance business in areas where insurance is critical—for example, municipal liability insurance?

What effect do the foreign reinsurance companies—for instance, Lloyd's of London—have on our domestic primary insurers practices? Is there a need for the federal government to license these foreign reinsurers?

Is the insurance industry facing an insolvency crisis? Should there be a federal solvency mechanism like we have for the banks?

To what degree is the current insurance crisis just a reflection of the cyclical nature of the insurance industry? When, if ever, will it correct itself?

During the two days of Commerce Committee hearings I will be listening closely for answers to these questions. Thank you, Mr. Chairman, for providing this forum for us.

Senator HOLLINGS. What we are hopefully having is an educational session in the Commerce Committee over the period of several weeks to create a better understanding by the Senators and thereby the public of insurance, its costs, and what is really occurring in the insurance market.

The approach that we must respond with Federal legislation for tort reform goes against the common law, the law that has evolved within the several States.

If the State law should be changed, then why not "reform" contract law? Recently, there has been a contract case between Pennzoil and Texaco, and Pennzoil was awarded over $11 billion in a verdict. This is more than all the product liability cases in many years put together. This does not reflect the attitude of the people in America as they are just too litigious. They are suing everybody for everything.

People are also ready to award large damages where an institution has committed a wrong. In the *Georgia* case, the university fired a teacher and the award was $2.5 million. That is another example of a high verdict that does not have to do with the product liability tort reform that many are pushing as a solution.

And then, of course, there is the issue as to who is really getting the money. I have practiced on both sides. I loved that hourly rate of the defense bar. In fact, if you want to see something that is offensive, come see this Washington lawyer crowd up here.

This room is full of them here. I have to sit here and listen to those guys making $250,000 at an hourly rate at that hearing table. When the whole thing clears, we will find out that the defendants' lawyers delay the cases and run up the cost. People do not get injured and then run down to a lawyer's office. They usually go to a hospital somewhere. The adjuster comes by and he tries to get by with doing nothing.

The lawyer for the insurance company gets the case on that hourly rate and milks it for all he is worth. And we are going to hear from witnesses that more money is going to the defendants' lawyers than is going to the plaintiff's lawyers on the contingency basis.

So, now let us hear what some of the witnesses are going to say.

The CHAIRMAN. All right. First is Senator Simon. We are delighted to have you with us, Senator.

STATEMENT OF HON. PAUL SIMON, U.S. SENATOR FROM ILLINOIS

Senator SIMON. Thank you very much, Mr. Chairman. First, I commend you for holding the hearing. I agree with my colleagues here who said we have to look for solid answers, and not simply for the easy, dramatic answers. Like all of you, I have just spent a week out in my State. Let me just tick off a few little things that have happened.

The little village of Buncombe, IL, has $6,000 total revenue. They just got their insurance bill—$5,600. Blue Island, IL, got their insurance bill. It went from $175,000 to $729,000. They made a decision to increase their village taxes 30 percent for liability insurance. A firm, I probably should not use their name without getting their permission, but one of the major firms in Illinois, employs 11,000 people. I met with the officers of the firm Friday. The liability insurance for their board of directors went from $125,000 to over $5 million. You know, you are talking about staggering amounts here. One of the great universities of our State just has been informed that insurance for the university's board of trustees is going up by 2,000 percent.

Now, I do not think there are any single answers to this problem. It may be that we have to take a look at tort law, and States have been doing that. It may be that we have to also take a look at, and I personally favor modifying the antitrust laws. The McCarran-Ferguson amendment to the antitrust laws that excludes insurance companies from provisions of the Sherman Act was not passed as a special amendment by either the House or the Senate. It was added in conference. That is how you have the provisions that permit the insurance companies to get together and say we are not going to insure certain groups or we are going to charge so much.

I happen to think that is not good public policy. I do not think changing or modifying the McCarran-Ferguson Act will in and of itself overnight mean there are going to be dramatic changes in rates, but I think it provides protection for the public that ought to be there. I do think insurance companies ought to be able to exchange risk information. If there are special risks in South Carolina, they ought to be able to know about that. But I do not think they ought to be able to get together and say, let us charge so much for this industry.

Incidentally, some executives of the insurance industry probably are on record as favoring that change. One is a fine insurance company based in my State, State Farm Insurance. The chief executive officer of another major insurance company, whose name you would all recognize, told me he does not want to go on record publicly for this, but privately he thinks that is a change that is desirable.

And I think one of the other things that this hearing will help to focus attention on is that the insurance industry is simply frightened. Earlier this decade they were grabbing out for everything they could get, including retroactively insuring the MGM Hotel fire in Nevada, which is one of the most incredible things. I think the rest of us would have a hard time getting insurance after a fire for the fire, because when interest rates and returns are very high, the insurance industry was grabbing for all kinds of things.

But now they have seen some court decisions, and there is no question we have had some jury decisions that are excessive. But, for example, the beer distributors I met with in the past week tell me that the payout compared to the premiums they have paid is less than one-third. The day care center people tell me it is 5 percent of what they had paid in, and yet day care premiums are going sky high. And it is happening in all kinds of businesses including roller skating rinks, school districts. You know, just everywhere I go I am running into this.

I talked to the hospital administrator in Ottawa, IL. To get 1 million dollars' worth of insurance, they have to pay $800,000. He says, "Our little hospital cannot afford $800,000. We are not a hospital that has problems." So, they decided to work out a self-insurance program. And maybe—and this is something your committee has to look at—there are ways that we encourage associations to self-insure. Service stations in Illinois, some of them cannot get insurance, and these are service stations that have not had any problems whatsoever. It is a major problem. I do think we have to look at it. I think we have to do something, and the monopoly provisions, I think, are one small step that can help. Beyond that, where we go, I do not know. I tend to think it is a mosaic where there are going to be a lot of little pieces, with no single dramatic answer, but your willingness to lead on this is extremely important for the Nation.

I would be happy to answer any questions, Mr. Chairman.

The CHAIRMAN. Thank you very much.

Senator Long.

Senator LONG. Thank you. Good statement, Senator.

The CHAIRMAN. Senator Gore.

Senator GORE. It is a good statement, and we appreciate your leadership on this issue. I have no questions.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. No.

The CHAIRMAN. Senator Trible.

Senator TRIBLE. No.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. Senator Simon, what is your solution? I understand just as you do, that such groups as cities and boards of directors are being sued. I mentioned earlier that the reaction of the American public today is that corporations should not get away with selling defective products or breaking contracts. The American public believes that the individual should not be given the institutional bum's rush. That is the reason for the *University of Georgia* decision—where the actual damage was less than half a million dollars, but the punitive damages were $2 million.

Now, that is not going to be solved by doing away with McCarran-Ferguson.

Senator SIMON. No and——

Senator HOLLINGS. Excuse me. What is your solution for that little town? The city fathers up until recently had no liability whatsoever. The king could do no wrong. Now the courts have changed, and the king can do a lot of wrong.

I am looking for the time when they can sue you and me for voting the wrong way on a bill and I do not know whether we can get insurance to cover us for that. But what would the abolition of McCarran-Ferguson do to solve the problem?

Senator SIMON. There is no one who can tell you that it will absolutely solve the problem. I think it is fair to say, and I have met now with probably a dozen different insurance executives talking about this thing that the very hearing you are holding is putting some pressure on the insurance companies to take another look at what they are doing. It is a frightened industry. You can calm them down a little bit, but McCarran-Ferguson, it seems to me, has the possibility of saying to the insurance industry you are not going to be treated any differently than anyone else, and it is wrong for you to get together and determine rates or determine that somebody cannot be insured.

Right now there is nothing to prevent the insurance industry from getting together and say we are not going to insure roller skating rinks. I do not think they ought to have that authority.

Senator **Hollings**. We could repeal any exemption they have from the antitrust laws. At the moment they correlate all this information. I didn't totally understand your statement. I gather you feel that the Federal group could know all these things and understand and appreciate the impact nationally. But then in another part of your statement, I understood that you felt they should not be getting together and colluding.

Senator **Simon**. I think it is perfectly proper that they share information on risk factors. If there are serious problems with roller skating rinks, they ought to be able to share that information. I do not think they ought to be able to get together, as they can now under the law, to say we are not going to insure roller skating rinks, or let us get together and decide we are going to increase the rates 300 or 600 percent or whatever they want to do.

I do not think that ought to be possible, and that is now legally possible under the law.

Senator **Hollings**. So, really you feel that the exemption from the antitrust provision would get at the problem better than perhaps getting a big Federal commission together. Is that not right?

Senator **Simon**. I think it is a small part of the answer. I do not know what the whole answer is. That is why I am here. I think the wisdom of Senator Danforth, Senator Hollings, and the rest of the committee is going to provide some answer. That is why I think we have hearings, to try and search for answers. I think eliminating this antitrust provision is one part of the answer.

Senator **Hollings**. We see the State legislatures reacting. There are over 1,000 bills in the State legislatures. Many States are moving like California to limit damages. Should not the market forces work? I hear there are not going to be skating rinks. What is to prevent us from starting an insurance company to insure skating rinks? I think the market forces would work pretty well, don't you?

Senator **Simon**. The market forces can, but the problem is the time gap between the time that you can get the insurance company going for roller skating rinks, and that is not a bad example. There is not going to be a heck of a lot of people interested in starting insurance companies for roller skating rinks or moving into that field. It is just a tiny little thing, and in the meantime people are going out of business. That is reality.

Senator **Hollings**. Thirteen weeks, we asked one, Guaranty Insurance Trust—I did it myself for Manny Cohen. He used to be the Chairman of the Securities and Exchange Commission. You can get a company started quickly. You can make a lot of money. I will talk to you later. Let us look at those insurance——

Senator **Simon**. All right.

The **Chairman**. Senator Pressler.

Senator **Pressler**. I just wanted to ask my colleague a question about contingency fees. By the way, I want to compliment you on your statement. I enjoyed serving with you in the House and the

Senate. But do you have any thoughts for this committee on tort reform, particularly in the contingency fee area? Is it something the Federal Government should get involved in?

Senator **Simon**. I guess my inclination is for the Federal Government not to get involved, but I am not sure. I do read about some of these excessive things, and the Texaco-Pennzoil thing. I do not know if we should pass laws that are going to deal with that kind of situation.

The other point is, and I heard you make it as I was walking in, that there is not much evidence from the States that have put on some limitations, that there are any lower insurance rates there than in the States without limitations. That takes a little more time for that to come about. While I guess at this point I am open, I am not inclined to think that that is going to provide much of an answer.

The **Chairman**. Senator Simon, thank you very much for your testimony. We have some 15 witnesses on the list today, and I have asked each of them with one exception to try to stick within a 5-minute time limit. You do not have to ask for permission for your full statements to be put in the record. They will be put in the record, and they will be reviewed with great care.

The one exception is the next witness, Mr. Albert Beer, who has a more extensive presentation to give us. Mr. Beer, if you would step forward, please.

STATEMENT OF ALBERT J. BEER, FCAS, MAAA, VICE PRESIDENT, TILLINGHAST, NELSON, AND WARREN, INC.

Mr. **Beer**. Good morning, Mr. Chairman, members of the committee. My name is Albert J. Beer, and I am vice president and consulting actuary with Tillinghast, Nelson, and Warren.

As a matter of background, prior to joining Tillinghast, I served for 7 years as professor of actuarial science at the College of Insurance in New York City. My professional credentials include fellowship in the Casualty Actuarial Society and membership in the American Academy of Actuaries.

I think it is important to mention here I am not here to argue a particular point of view nor to advocate any specific solutions to the problems which prompted this hearing. I have been asked to provide the committee with a brief objective summary of the complex factors which have contributed to the current insurance environment.

I will present my testimony over the next few minutes, and then be available for any questions. Finally, I would like to make it clear that any opinions expressed during this testimony are my own and do not necessarily represent those of my firm.

The **Chairman**. Could you speak directly into the microphone, Mr. Beer?

Mr. **Beer**. Sure.

Over the past 30 years, the U.S. property casualty industry has exhibited a fairly regular cyclical behavior. A true understanding of the affordability and availability problems to be discussed during these proceedings requires a basic knowledge of the nature of the cyclicality and the unique factors contributing to the severity with which insurers have reacted.

An insurance company derives its income from two primary sources; namely, premiums contributed directly by its policyholders and the investment return generated from accumulated assets. In this context, underwriting gain and loss is defined as the difference between premiums earned during a specific calendar year and losses and expenses incurred during that year.

Losses consist of claims payable to or on behalf of the policyholders. Expenses include claim adjustment, acquisition, and other overhead costs as well as policyholder dividends. By the very nature of the insurance contract, there is a lag between the time at which premium is collected and the time at which claims related to the underlying coverage are ultimately paid.

In some lines of insurance where litigation is common, some such as medical professional liability, payment may not occur for as many as 10 to 20 years after the policy has expired. Funds set aside for the ultimate settlement of these incurred claims are referred to as loss and loss expense reserves, and appear as liabilities on the insurer's financial statements.

In addition, not all premiums received by an insurance company during a particular calendar year are deemed to have been earned during that period. Therefore a reserve for unearned premiums also establishes a liability. These reserves, along with available capital and surplus funds, may generate a significant amount of investment income for the insurer.

One of the most common methods of presenting insurance results is the form of statutory preta operating income. For any given year, the values derived by combining the underwriting gain or loss with investment income derived from all assets prior to consideration of capital gains and Federal income tax adjustments.

I have prepared a number of slides, and they are accompanied by exhibits in the back of this presentation. Exhibit 1 details pretax operating income figures for the property casualty industry from 1967 to date. And again, as I mentioned before, a copy of that slide is included in the back of my presentation. A review of these data reveal two obvious characteristics, the cyclical nature of the insurance company's performance and the severity of the decline during the most recent 2 years.

An analysis of the role each component has played in the overall result will help in understanding the insurance perception of this problem and the approach they have taken to resolve it. If I may, this exhibit 1 is an illustration of those pretax operating results that I just discussed. That is, the difference between underwriting income and investment income attributable to the insurance operation.

The exhibit 2 that I am discussing breaks this down into its two contributory components. The underwriting investment data which support these operating income figures are displayed on exhibit 1.

Historically, the insurance industry has generally performed in a manner consistent with traditional economic theory. During periods when profitability is perceived to be relatively high, for example, in 1972 and 1978, just to make a couple of observations, your underwriting income is the blue line, your investment income is the green line, the combination of the two give you your net income, which is represented as the red line in this particular graph.

Again, the cyclicality is fairly well demonstrated, and as I mentioned before, 1972 and 1978, generally new capacity is drawn into the marketplace, generally resulting in a highly competitive pricing environment, and eventually deteriorating underwriting results. A couple of points to be made, that the underwriting results have continued to deteriorate since approximately 1978. Investment income, on the other hand, has also continued to rise.

The decline continues as underwriting losses approach and at times grow beyond the level of investment income. Eventually the operating result reaches a level low enough to cause an overall tightening in the marketplace. This market constriction might consist of reduced writings by a number of participants who refuse to compete for business at unprofitable prices or an actual withdrawal from the market entirely. This lessening of competitive pressure encourages a strengthening of prices in an attempt to achieve more satisfactory underwriting results. As premiums begin to rise, operating results improve, and the cycle repeats itself.

I would like to spend a few minutes discussing the current cycle, because I think it is important for everyone here to have a feeling for how it arose and particularly the contributions that each of these two pieces that I have just discussed lends to the overall result.

While this pattern has manifested itself repeatedly in the past, a series of unusual factors both external as well as internal to the insurance industry have contributed to create the most severe decline and in turn the most violent market constriction in the history of the insurance industry.

Topic No. 1 I have chosen to discuss is investment yield. The single most important factor influencing the precipitous decline in pricing over the period 1979 to 1984 was the unprecedented level reached by interest rates. As the prime rate reached 20 percent per annum in the early 1980's, insurers entered an intense price war to maintain market share and take advantage of these exceptionally high investment yields under the premise that $100 collected today would create $120 available to pay losses 1 year from now. Many underwriters initially chose to charge $100 for those $120 risks. Soon other competitors felt that $95 would lure the account, then $80, and the downward spiral would continue. As competition became more keen, insurers looked to many of the third-party liability lines as a source of large premiums which would result in losses payable years into the future, while presumably generating significant investment return in the interim.

For this reason, the price cutting was most severe in commercial liability coverages where premiums tend to be large and claims are paid long after the premium is collected. To illustrate this point, please consider exhibit 3. This graph shows the vastly different underwriting results between the commercial and personal lines. In this slide I have used another industry-type measure, and this measure is used to express the underwriting performance. It is called the "trade ratio." The combined or trade ratio—you will probably be hearing that phrase over the next couple of hours—is the sum of the loss ratio, that is, incurred losses and loss adjustment expense presented as an expensive annual earned premium, and the expense ratio, underwriting expenses as a percent of annual written premium.

A trade ratio of 100 percent implies that the ultimate loss and expense arising from $1 of premium would be exactly $1. A trade ratio below 100 percent indicates that an underwriting profit was achieved. If it is greater than 100 percent, there was an underwriting loss. Since investment income is not included here, it is possible to turn an operating profit, even if the trade ratio exceeds 100 percent. However, as a relative measure of underwriting performance, the trade ratio is a reasonable indicator of the ability of the industry to maintain a stable relationship between income and expenses.

Over the past 20 years, the same cyclicality described above has manifested itself in trade ratio results. However, even during the most volatile periods, the trade ratios for the personal lines and commercial lines had been relatively similar prior to 1980. I think you will notice that exhibit 3 demonstrates that fairly well. There were some slightly out of sync situations, but generally their aberrations are reasonably consistent, both with regard to frequency, timing, and amplitude.

Exhibit 3 shows that as a result of significantly more price cutting in the commerical lines during the 1980's, the commercial trade ratios far exceeded those of personal lines, so again, if you will notice, commencing in approximately 1980, as insurers went after the larger premium volumes, figuring that they could hold onto those dollars for longer periods of time and take advantage of the investment income, they tended to underprice more those commercial lines. That shows up in the trade ratio as basically, as you can see, a disparity starting in approximately 1980 between the personal lines and the commercial lines. There was some deterioration in the personal lines underwriting, but you see it is more dramatic in the commercial lines.

During this period it was not uncommon to see premiums for commercial risk reduced 20 to 30 percent per year. Unfortunately, today we hear very often about prices increasing. One of the reasons for those tremendous increases, and we may touch upon this later, is the fact that there were significant decreases going on during these years, and that essentially has shown up in this deterioration of the underwriting ratios.

Unfortunately, the prime rate fell quickly, eventually reaching the 10-percent range less than 2 years after it had once achieved twice that level. Imprudent underwriters, however, continued to cut premiums which were already insufficient to cover those losses, whose reserves are earning far less investment return than originally contemplated.

Referring back to exhibit 2, the figures show that while the industry generated a significant amount of investment income during the early 1980's, and again that is shown by the steadily increasing investment income green line, that goal was achieved by investing thinly priced premium dollars, dollars that underlie coverage that will cause losses to be paid long after.

Eventually those losses related to this premium began to roll in heavily during 1984 and 1985. The disparity between the rise in investment income and the even sharper decline in underwriting income resulted in the worst net underwriting performance in the industry's history.

A second consideration is the reinsurance market and its deterioration. The rampant price competition that existed over the previous 6 years was not restricted solely to our primary insurance industry. In fact, the trade ratio performance of the reinsurance industry was even worse than that of the primary. Since the reinsurer generally deals with claims some time after the initial insurer has been notified, the cash-flow between premium receipt and loss settlement is even more protracted.

As with primary underwriters, the perception of high interest rates long into the future also caused reinsurers to underwrite in a less than thorough manner. As exhibit 4 shows, there was a reasonably consistent relationship between reinsurance and the primary industry results, once again, prior to approximately 1980. You will notice the same cyclicality, roughly the same frequency and amplitude.

Until recently, primary insurers were in fact indirectly encouraged to continue price cutting since it was relatively easy to lay off much of their risk at inexpensive rates, the point being that as bad as the situation was for primary insurers, it was in fact even worse for the reinsurers.

The subsequent adverse experience of reinsurers has had a serious effect on the current cost and availability of reinsurance, which in turn affects the ultimate cost to the consumer of primary coverage.

Third, there is the consideration of statutory and judicial broadening of coverage. Various State and Federal legislative actions—coincidentally, you will notice that largely took place in around 1980, and a couple of examples are the CERCLA or Superfund Act of 1980 or the Motor Carrier Act of 1980.

These acts have significantly expanded the scope of coverage offered under the traditional insurance contracts. Financial responsibility requirements mandated by these laws prompted insurers to increase their limits to multimillion-dollar levels at a time when premiums were being continually reduced, and high-risk exposures were gradually being accepted without adequate underwriting.

Recent judicial interpretations of these statutes may have also played a role in curtailing insurers' appetites to write pollution environmental impairment coverage. For example, a number of court decisions have blurred or eliminated the distinction between terms such as sudden and accidental and gradual pollution.

Insurers are now discovering their exposures which they intended to exclude in their policies are now interpreted as being retrospectively covered. Invocation of the doctrine of joint and several liability has also resulted in a number of cases where any one of the involved parties may be declared liable for all damages regardless of the degree of negligence.

As a result, for example, insurers writing commercial trucks hauling hazardous waste may actually be responsible for claims arising from an improperly managed landfill. Also, an increased propensity for litigation and rising level of awards growing out of the entire tort liability system aggravated already poor underwriting results.

Beginning in mid-1984, the insurance industry finally realized its self-destructive price war would have to end. Direct investor support was very weak, and major corporate entities such as American Express, IT&T, and Xerox were suffering serious loss of earnings largely due to the poor performance of their insurance subsidiaries.

A.M. Best's annual evaluation of the relative financial quality of insurers also reflects the deteriorating financial position of the industry as shown on exhibit 5. Best has reviewed 1,755 companies in 1985. Only 25 of those, 1.4 percent, actually had their ratings increased; 331, almost 19 percent, had their ratings reduced. In fact, more than 20 companies were actually declared insolvent.

While we are here, this may be a good time to discuss the fragmentation of the industry, since we are talking about the number of carriers involved. Currently there are over 3,000 property casualty companies licensed to sell property casualty insurance in the United States.

No one of those carriers has more than 10 percent of the property casualty countrywide market, and in fact excluding State Farm, which is 9.5 percent, and Allstate, which is 5.5 percent, and both of those are heavily personalized companies, no other company has more than 3.5 percent of the property casualty countrywide market.

It was in this environment that ensurers began to increase premiums in an attempt to achieve a more appropriate rate level. One of the terms you have heard very often is the concept of capacity. One of the most common measures of an acceptable level of writing is the premium-to-surplus ratio. It is generally suggested that there be $1 of surplus for every $2 of premiums written, that is, a 2-to-1 premium-to-surplus ratio.

Regulators generally become concerned when this ratio exceeds 3 to 1. In this sense, surplus becomes a measure of the ability, i.e., capacity of an insurer to write business. The poor operating performance of the early 1980's resulted in many insurers experiencing low growth, and some even suffered an erosion of the surplus at year end 1984.

During 1985, the industry surplus was supplemented by over $5 billion of contributed capital. Despite this infusion, there was insufficient surplus for many insurers to support the increased premiums over all lines, and still remain safely within regulatory premium to surplus guidelines. Therefore, insurers chose to withdraw or restrict coverage for a number of market segments.

In 1985, most insurers reevaluated their entire book of business with an eye toward potential profitability. Since commercial line trade ratios have been so high, it should not be surprising that the commercial liability market suffered the greatest premium increases and restriction of coverages.

In some cases, it was the fear of unquantifiable future exposure rather than actual loss history itself which caused the insurers to leave entire segments of the market.

That brings us to the current environment after the cycle has turned. Industries such as transportation, manufacturing, hazardous waste management have historically depended on insurance to provide stable risk financing and comply with financial responsibility requirements. During the early 1980's most of these industries had very little, if any, difficulty obtaining desired coverages at prices which even many insurers will admit appeared less than adequate.

Unfortunately, the depressed cost of insurance provided no additional incentives to maintain stringent safety standards or maintain detailed loss records. During this period, insurers discovered that legislative and judicial action were broadening the scope of already thinly priced coverage.

In addition to the unexpectedly high level of losses related to coverage that they apparently underpriced, insurers were also being forced to pay claims which they thought were specifically excluded. The perceived severity of these problems caused many insurers to take such dramatic action as large price increases, restriction of coverage terms, midterm cancellations, and outright withdrawal from certain markets.

It is not surprising that the insurance buyer has reacted with anger and frustration. In their minds, the purchase of insurance was intended to stabilize their financial performance. In recent years, the amplitude and frequency of abrupt changes in their premium costs have often been more volatile than their actual loss experience.

Availability is an even more critical issue, where large segments of certain industries cannot find sufficient limits of coverage or in some instances any protection at all. This chaotic environment was abetted by new and inexperienced insurers entering a variety of commercial markets at reduced prices. In general, the price competition that followed was not based on sound underwriting or particularly favorable loss experience of those industries that benefited.

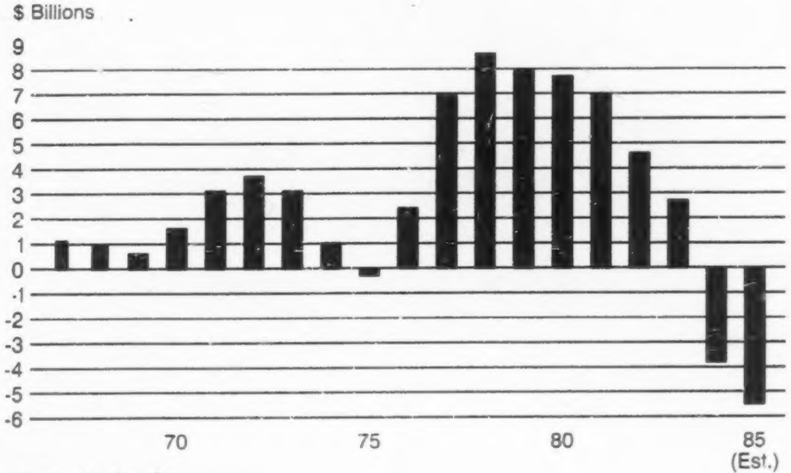
It is for this reason, I believe, that buyers are concerned that the current substantial rate increases in coverage restrictions are being indiscriminately applied without benefit of industry specific experience.

I think it is obvious that the current problems are complex, and many points of view are to be considered. Although it is doubtful that there are any simple solutions, I hope this testimony provides a broad enough background to allow the committee to understand and address the key issues.

Thank you for your attention.

[The exhibits referred to follow:]

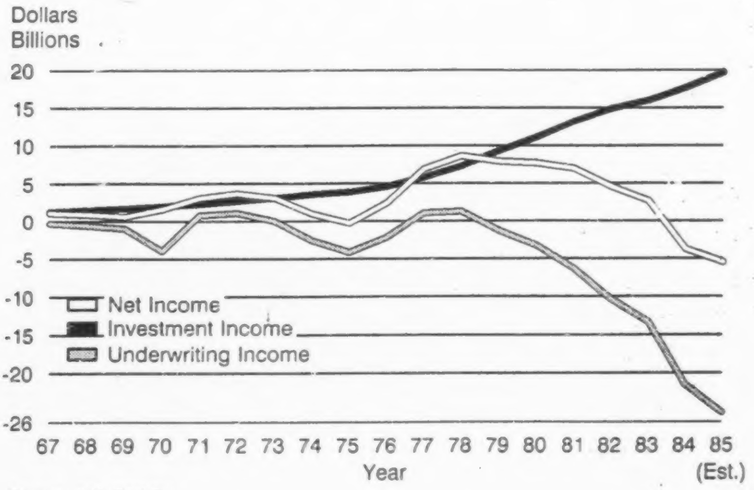
P/C Pre-Tax Operating Results



Source: A.M. Best Co.

Exhibit 1

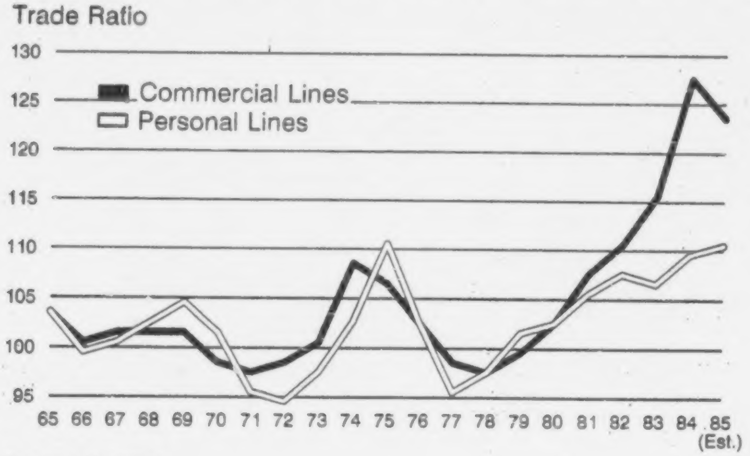
Property Casualty Industry



Source: A.M. Best Co.

Exhibit 2

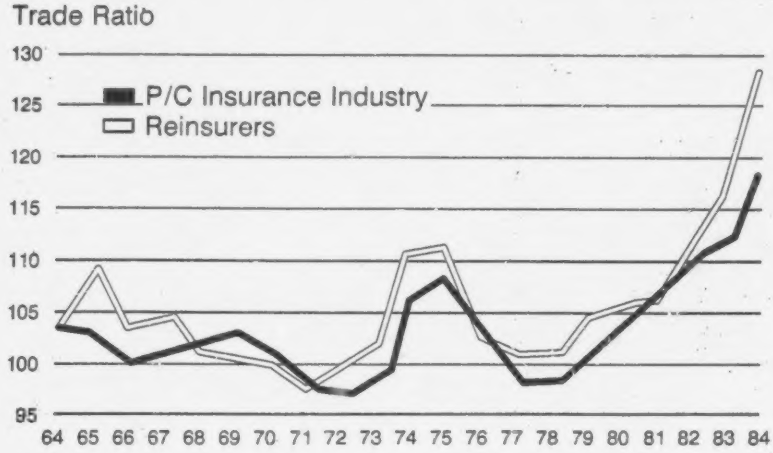
Trade Ratio Comparison
Commercial Lines vs. Personal Lines



Source: A.M. Best Co.

Exhibit 3

Trade Ratio Comparison
Reinsurers vs. The Industry

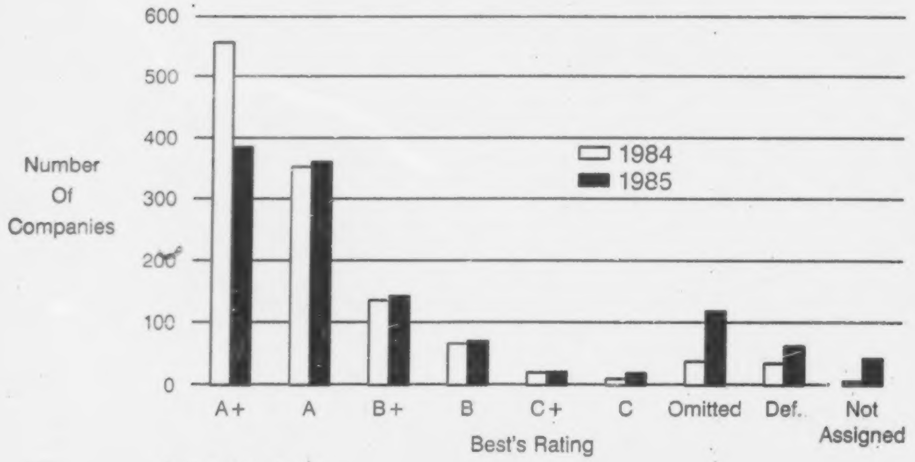


Source: A.M. Best Co.

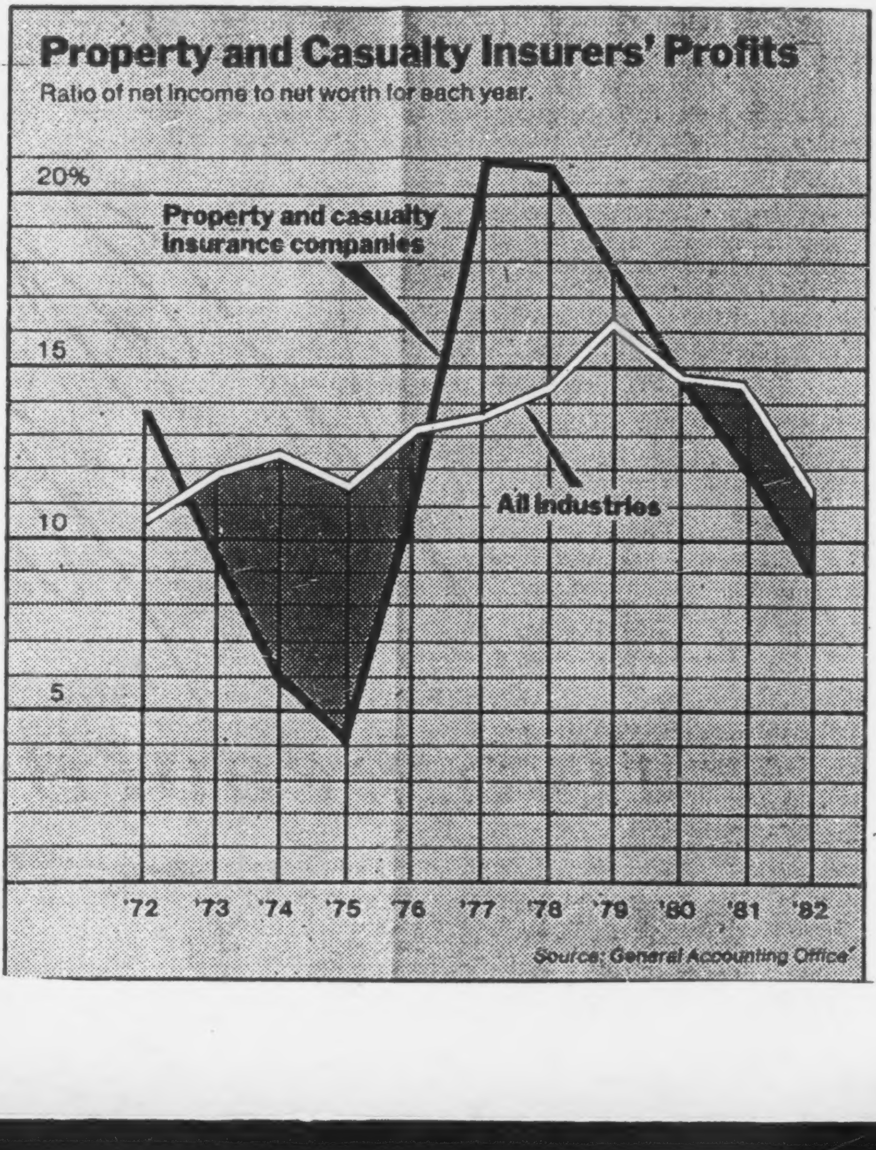
Exhibit 4

Exhibit 5

Best Ratings of Property/ Casualty Companies



Source: A.M. Best Co.



Property and Casualty Insurers' Profits

Ratio of net income to net worth for each year.

Source: General Accounting Office

The **Chairman**. Mr. Beer, thank you very much for a very informative presentation. You have stressed the cyclical nature of the insurance business. Does this mean we are going to ride out this particular problem, that it is a blip, that eventually things will even out and we do not need to be particularly worried about it? Or do you think that we are now beyond the cyclical problem and we should be looking at some more structural difficulties that the insurance industries are having?

Mr. **Beer**. There are two questions. Let me answer the first. In essence, do not consider this a blip, because as I said before the pattern has repeated itself in the past. I do not think that the cycle itself in this particular turn of the cycle is unusual. I do think the severity of the turn in the cycle, both the precipitous decline and the speed with which it declined and in fact the rebound, how quickly the companies have tried to come back, I think that is unusual. I would not necessarily call it a blip. I think the severity or perceived severity of the situation has caused severe reactions.

To answer your second question, it is likely that this type of cyclicality will continue in the future, hopefully not to this particular extent. As I tried to point out, I think there are a number of unusual simultaneous circumstances which occurred in the early eighties, investment return probably being one of the most obvious. Also, fairly significant changes in court interpretations have made this cycle a bit more severe than the ones in the past.

From a merely projection point of view and the nature of the market, I would expect that there be some cyclicality in the future. It is unlikely that it would suffer this severe extent unless, of course, we had another culmination of a number of problems such as massive changes in investment income and claim costs running out of control.

The **Chairman**. The claims cost running out of control would be, I suppose, the most constant pressure on increased difficulties in insurance, would they not? I understand the cyclical thing, that the industry was almost engaged in a price war, as I understand your testimony, trying to get in premiums so they could invest the premiums. Then the investments were not producing as much income as they believed they would. Now they are being much tighter in their practices. That is the kind of thing that is likely to ebb and flow with the changing times.

However, if you have a tort system which is extremely unpredictable, where businesses are subject to successful tort litigation for things that they never dreamed of 5 years or 10 years ago, that would tend to be beyond the cyclical problem and be an ongoing problem for the future, would it not?

Mr. **Beer**. Yes. Perhaps one of the problems with that, if there is a constant pattern, then generally the cyclical pattern will react around that. There has been inflation for a number of decades. The degree of that inflation has changed, but the cyclicality reacted fairly constantly to relatively small changes in inflation.

I believe what the insurance industry is concerned about and they believe they have experienced in the last few years is the social inflation over and above just the economic inflation.

The **Chairman**. Senator Simon, when he testified, talked about the possibility of removing antitrust immunity and the fact that he thought there was a lack of competitiveness in the insurance industry. On the other hand, your testimony indicated the opposite, or did I interpret it correctly? That is, as I understood your testimony, the insurance companies were very busily out hustling business, reducing premiums, and trying to get the funds in to invest.

Who is right? Is it a competitive industry with cutthroat competition now that has led to cyclical swings, or is it an anticompetitive business?

Mr. BEER. In my opinion, the competition is no different now than it was in the 1980's, but I think the direction of that competition is what has directed attention. Quite frankly, the same type of mass movements—in fact, some critics of the industry call it a lemming type movement—occurred in the eighties, and yet no one—in the early eighties, and yet no one was concerned about the anticompetitive aspect of that when the industry moved in unison because essentially it was favorable to most of the consumers.

I think that was, as you mentioned, just simply the result of a fairly fragmented, highly competitive industry. I think essentially the same situation has occurred now. I think essentially the market shares are roughly the same as they are now than they were in the early eighties. There are very few situations where there is a significant portion of the market in any one area.

I think essentially they were all brought so low by their own management decisions, and now what they are trying to do is recover from that in unison.

The CHAIRMAN. Do you think it was independent management decisions? You do not think it is basically an anticompetitive or noncompetitive industry?

Mr. BEER. In my personal opinion, I personally believe it was individual management opinion.

The CHAIRMAN. Do you think that the Product Liability Risk Retention Act of 1981 and an expansion of risk retention possibilities, would that be a good thing? Would that help out in this area?

Mr. BEER. One of the areas I have been heavily involved in over the last year is assisting companies in getting involved in sharing more of their own risk. My personal opinion is the Risk Retention Act was a very good idea. Unfortunately, it was introduced at a time, as we have just shown in the slides. where rates were decreasing so much that very few, if any—I believe one group of companies have formed an organization under the Risk Retention Act, the reason being, I would presume, they felt that the price for the insurance was cheaper than the actual costs which they would bear by forming these groups.

The Risk Retention Act, as you are obviously aware, was formed primarily for product liability coverage. We have done some work with hazardous waste management, and there has been some discussion about expanding it into that area, and now, as you mentioned, there is even talk of expanding it beyond into other lines of business.

I think one of the problems with the commercial marketplace is, they essentially did not make wise use of the capacity that was there, and that is both players' fault. The industry essentially gave away their capacity at what in my opinion very often was very low, if not underpriced rates. Therefore it would be an imprudent short-term decision to self-assume more risk than you could lay off by simply paying them underpriced premiums.

Nowadays one of the alternatives, and very often many companies are taking that, and it was mentioned this morning about going self-insurance, many companies are starting to bear more of that risk themselves. I think most companies are able to bear more risk than they had historically laid off. Most, at least, and I have dealt with some of the sophisticated companies, but many of those, their decisions were predicated on the short-term price of insurance as opposed to bearing or wearing through this long-term cyclicality.

So, a Risk Retention Act would encourage more self-insured assumption of risk. The fear that the insurance companies have, and it would apply to those who form under the Risk Retention Act, is, is it a quantifiable, manageable risk, regardless of whether it is done in the private enterprise, your own industry, or whether it is done outside through an insurance mechanism.

The concern is that these Risk Retention Act companies are, in fact, able to control their costs. One of the side effects of a Risk Retention Act formed group, I think, would be, companies would become a lot more aware of the safety and their own losses. One of the unfortunate instances that I have seen is many companies, and I alluded to this in the testimony, many companies chose not to keep very good records of their own loss experience, because the insurance companies were simply covering them.

Again, it is difficult to blame them in that short-term context. Companies that have thrived, I think, during this crisis are ones that truly know the measure of their risk, realized if and when the insurance companies crossed the threshold of when it would become more economic to bear that risk, so, I think, an overall movement toward more self-insured retention, all of us personally have been forced into that by higher physical damage deductibles, and it might be a small analogy, but, I think, it is typical of a way of making better use of the capacity.

Use the insurance industry to bear the unusual claims as opposed to relying on them to pay all the smaller claims.

The **Chairman**. Senator Pressler.

Senator **Pressler**. Let me go back to exhibit 2, if I could, and I had a question about exhibit 2, the property casualty industry, or at least as it appeared on the board. Now, I understand the investment income chart, the net income line I can understand, but the underwriting income line on exhibit 2 goes down dramatically from 1980 to 1985.

Now, as I understand it, the investment income could have gone down because interest rates came down, but why did the underwriting income go down so much between 1980 and 1985?

Mr. **Beer**. OK. Let me answer that in two ways. First of all, as you mentioned, the investment income, in fact, continued to rise, but at a less steep increment. In other words, you had more and more funds, and they were not generating investment income, so you were getting more investment income, but if they had increased at 20 percent, you would have seen a much steeper investment income line.

I might also add, and it is somewhat off the cuff, if, in fact, investment income had continued at 20 percent, we may not be sitting here today.

Senator **PRESSLER**. What about the underwriting income?

Mr. **BEER**. The underwriting income is essentially the difference between premiums taken in and losses and expenses incurred during any particular calendar year.

Senator **PRESSLER**. But between 1980 and 1985 it went down dramatically. Why was that?

Mr. **BEER**. Mainly because premiums were being cut while losses continued to rise again. The underwriting income is essentially the difference between premiums coming in and losses going out.

Senator **PRESSLER**. What caused that? Was it because of an increased number of lawsuits or was it merely because rates were going down?

Mr. **BEER**. It was a combination of the two. Rates essentially were held relatively constant. There was very little growth in total premium coming in, and there was an acceleration of incurred losses.

Senator **PRESSLER**. In your statement is there a good statistical analysis of why the underwriting income went down so much in those years?

Mr. **BEER**. There is not a good statistical analysis within this particular testimony. Essentially the statutory results are published within the industry that I can present to you that could show you by year the differences between premium and losses, but essentially that underwriting income is loss driven.

Senator **PRESSLER**. I know, but what caused it? If you had to give two or three factors that caused it to go down, the principal ones would be what?

Mr. **BEER**. Essentially increase in size of claims.

Senator **PRESSLER**. Increase in size of claims?

Mr. **BEER**. That is correct.

Senator **PRESSLER**. Which resulted from lawsuits?

Mr. **BEER**. That is correct.

Senator **PRESSLER**. All right

Mr. **BEER**. In addition, more limits were being offered during that period of time, so ordinarily even if the same claimant had been paid 5 years before, it may not have impacted the insurance industry, but since the insurance industry was offering more coverage, it paid a greater piece of that loss. That is one portion, but the second is, there have been definite increases in the size of losses.

Senator **PRESSLER**. Would the size of decline in the underwriting income be a result of poor judgments or poor investments? Of course, they might have been judgments where the results could not have been foreseen. But is it all a result of tort claims, or is part of it a result of business judgments?

Mr. **BEER**. OK, clearly there is a lot more into the property casualty losses than just tort liability. There is physical damage, personal automobile physical damage, for example, so that is not entirely the tort liability system. Most insurers feel that is a significant portion, and clearly liability payments are a greater portion of the whole lost dollar, and many insurers have statistics that they feel justify the fact that liability losses have increased inordinately over the early eighties.

Senator **Pressler**. Would you submit to the committee the best statistical analysis, in two or three pages, illustrating why the net income line would go down? I suppose it did so in part because the interest rates went down.

Mr. **Beer**. That is correct.

Senator **Pressler**. But the underwriting income would theoretically have nothing to do with interest rates. That would be a combination of factors. But I do not think we have that information from the industry. That is one of the things I have been trying to get at in these hearings. I have been so frustrated. I want to know why the underwriting income went down from 1980 to 1985. Is it all a result of big judgments in the courts? Is part of it a result of bad management on the part of the insurance companies? Is part of it a result of something else?

We are told, more or less, or rather it is implied by this chart that it is all a result of the bad tort system. If that is true, then that is a tool for us to use in correcting it. The insurance industry with its wonderful statistics should be able to tell us. I am a supporter of the insurance industry, but we must have that kind of information in order to legislation. Where could we get it if we cannot get it from you? You should be the man.

Mr. **Beer**. OK. I would be happy to provide you with some industry data. I hope this chart does not imply that it is all from the tort system. I do not believe I mentioned anywhere that it is strictly the tort liability system, but I agree——

Senator **Pressler**. OK, but what part of it is from the tort system—in your best judgment. What part of it is a result of bad business judgments, if some were made. I am not saying they are bad. That is what I am trying to get at. I think that would be a great addition to this testimony.

Mr. **Beer**. All right. I would be happy to provide that.

Senator **Pressler**. Let me ask you a second question before my time is up.

On the Risk Retention Act—by the way, I support it—what do you do about the real small companies who cannot get together because they are not a member of the club? You know, in life, or in companies, there is always somebody who does not quite fit the group. What about that little company?

Mr. **Beer**. There are a couple of options. One is to—and they are the ones who are probably suffering the most right now and have the bleakest future in my opinion, only because they probably did very little to collect any data, and even the data that they have is probably erratic, and many times zero. Senator Simon mentioned a few hospitals that had very good experience, yet they were still suffering large losses.

One of the approaches there is to investigate other ways of financing. Municipalities have approached it by means of bonds or at least having the potential to use bonds. Hospitals, if they get larger retentions, therefore they are looking for coverage above a fairly significant retention. Of course, that represents a greater risk to that hospital, and essentially the insurance industry is not providing the same financial support that it had done in the past through the reasons that I have just described in here.

It is not uncommon to see a great number of smaller entities pooled together. I have seen it done in transit systems. I have seen it done in municipalities. So theoretically the Risk Retention Act is one aspect, but any type of group program could theoretically help, and, in fact, we have counseled many of our smaller insureds in a particular industry to approach the insurance market in unison, showing themselves as a group, and try to demonstrate that profitability as a group instead of having the insurance industry try to underwrite each one individually.

Senator PRESSLER. All right. My time is up. There seem to be three things that the insurance industry attributes to the problem when they are tested. One is unwise underwriting practices. The second is shortcomings of the civil justice system. And the third is the cyclical nature of the industry.

Could you indicate on a 100-point scale the relative importance of these three factors as causes of the current crisis with a little statistical backup, because we just hear about these three reasons without really knowing what percentage of the problem comes from each one. You are an expert in this area, so if you could supply us with a three- or four-page paper with your conclusions on a 1-to-100-point scale regarding those three causes, what percentage you would attribute to each one, the cause of it, and why.

Mr. BEER. OK.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. Mr. Beer, what is the going rate for an actuary? I am not involving you personally.

Mr. BEER. Anywhere from $100 to $200 an hour.

Senator HOLLINGS. $100 to $200 an hour? If I had a company and had some actuaries, how much would I pay the actuary a year?

Mr. BEER. Oh, $50,000 to $70,000, I would assume.

Senator HOLLINGS. Let me ask you, is the crisis still persisting now? We in the Congress have heard, as Senator Simon has indicated from his travel home, from many insurance buyers. Do you think there is a crisis right now?

Mr. BEER. Yes; I do.

Senator HOLLINGS. What explains the good success now of the insurance stocks on the market? Everybody is buying them.

Mr. BEER. I do not want to get into the stock market per se——

Senator HOLLINGS. I do. That is a great indicator to me. The market forces operate. I am a big Reagan supporter on the market forces. They operate. You watch those insurance stocks. The casualty is going up, up, and away.

Mr. BEER. That is correct. I think if you recognize it is on a perceived improvement, one of the arguments I would address is the industry did so poorly for so long. I alluded to some of the Fortune 500 companies that lost significant earnings in what otherwise would have been profitable business, so I believe the market infusion is essentially a result of people perceiving an improvement from a poor loss situation to a profitable one.

Senator HOLLINGS. So the public itself is voting in the market affirmatively that the crisis has passed. They really feel it is a good invesment.

Mr. BEER. That is an interesting point. You use the word crisis, and I have done work for both sides, so I believe possibly the crisis with regard to underwriting losses or at least significant undwriting losses have passed for the insurance industry. I think there still is a crisis for the insurance buyer, so in that sense I think a crisis still exists and probably will continue to exist for another year or so.

Senator HOLLINGS. So it is really the companies trying to make up their losses for the low premium income that they had during 1981 and 1982?

Mr. BEER. I would like to address that on a theoretical basis, and then you can draw your own conclusions. One of the arguments that I constantly remind people of is the fact that one of the main reasons why insurance rates have increased so dramatically this year is because they have been brought down fairly dramatically over the last few years.

An analogy I like to bring up very often to both sides is to take a dollar rate and assume that it suffers a 50-percent rate decrease one year and then another 50-percent rate decrease, so theoretically in 1982 it was a dollar, in 1983 it was 50 cents, in 1984 it was 25 cents. You need a 300-percent rate increase to get that back up to a dollar in 1985, and that is assuming that a dollar in 1985 is equivalent to a dollar in 1982. So one of the unfortunate aspects of this is that all change is magnified.

Therefore I am a little concerned—that was a theoretical——

Senator HOLLINGS. You sound like my wife explaining the grocery bill.

Mr. BEER. Let me get back to your question. The reason I say that is the industry right now is trying to get back to adequate rate level or what they perceive to be adequate rate level.

Senator HOLLINGS. Now, is there anything at the Federal level we can do to retard or to assist that? Is it correcting itself? Is that what you are observing? Is that what you are testifying?

Mr. BEER. That is correct.

Senator HOLLINGS. The industry is doing it itself, without Congress, right now.

Mr. BEER. That is correct.

Senator HOLLINGS. And should that occur in the next year with the insurance stocks going up and the industry in a self-correctional mode at the moment, then the crisis would pass and you would not recommend any federalization of the insurance industry?

Mr. BEER. I certainly do not recommend Federal regulation simply to solve this particular crisis.

Senator HOLLINGS. Good.

Mr. BEER. Again, I think it is important to distinguish whose crisis it is, and the insurance buyer will continue to suffer this problem at least in the short term, and as far as unavialability perhaps in the long term, and I speak to industries like hazardous waste management, municipalities where it is difficult to get insurance companies interested in partaking in that business, where the perceived risk is extremely high, and in that case the perception is highly tied to the tort liability system.

Senator **Hollings**. As I understand it, the property-casualty companies have not paid any taxes in the last several years. Is that correct?

Mr. **Beer**. In general, they have not. There are two sides to that issue. I mean, if you continued to lose money here——

Senator **Hollings**. The Government is looking for money, and the property-casualty industry is not only writing off their losses or payments, but their perspective losses which they put in the reserves. It is a wonderful way to store a lot of money. It is hard to hold onto money in this society in which we live, but that is one of the wonderful ways to do it in the property-casualty companies. They have not paid any Federal taxes at all in the last several years. Is that not correct?

Mr. **Beer**. Largely that is correct.

Senator **Hollings**. Mr. Beer, one thing I wish you would provide us along the same lines that Senator Pressler has requested. We have a very difficult time getting any kind of loss records or payment records for incurred losses in product liability. The insurance companies will just not give it to us. It is almost like the automobile companies when we had the Fuel Economy Act.

You never could determine the cost of manufacturing an automobile out of Detroit, and we almost had to, after 3 years of hearings, guess at it. In a similar fashion, in product liability hearings in this committee over several years, we just have not been provided any accurate information. We hear the rejoinder about the tort system, and high verdicts, but we do not have the actual figures or any kind of study or any actuarial analysis of the losses paid out under product liability. Is there any kind of information along that line?

Mr. **Beer**. I certainly can make an attempt, although I will admit a large part of my sources will be the insurance industry.

Senator **Hollings**. Well, see how well they cooperate with you. I would appreciate it. Thank you.

The **Chairman**. I have one other question, Mr. Beer. Obviously, I am an amateur in the area, so I might be grossly in error. I would like you to help me out as best you can. My understanding of what an actuary does is to attempt to predict the losses in the future, of the costs of claims in the future, and to figure out what it takes in premiums to cover those future losses now.

My supposition is that in today's tort system there is a great amount of unpredictability, and that while ideally actuaries are dealing with known facts, claims of the past in trying to predict from the past what is going to happen in the future, now we are in a situation which really has changed dramatically in recent years, and there is much less predictability, so that actuaries have a much more difficult time anticipating what the payout is going to be in the future for clients, and that this unpredictability is something that is new in the business of insurance relative to what it was in the past.

Could you either agree or disagree or restate what I said in knowledgeable terms?

Mr. **Beer**. Well, first of all, I think it is far from an amateur's question. I think that is one of the most critical problems the industry is facing. They certainly perceive that to be the problem. I have heard it humorously referred to as nowadays trying to look out the rear view mirror to see how to drive straight. Essentially you are looking at what has occurred in the past.

The problem is that you are trying to use that to project what will happen in the future, and it may not be a very good indicator. I agree with you that that is a significant problem. Not necessarily that there is aberration. There always has been aberration. The greatest concern is the severity of that aberration, how quickly it can occur, particularly with a specific court decision such as Jackson Township and a number of others, where the whole premise upon which the statistics were based not be valid in the future. So I agree with you that that is probably one of the most significant concerns of the industry.

The CHAIRMAN. Therefore if what we do is to focus our attention on claims now, profits now in the insurance industry, if we attempt to take a snapshot of the existing system in the insurance industry with respect to claims paid, with respect to profitability, that might not offer much solace to somebody who wants to buy insurance now, because the premiums that they pay have to anticipate what the payout is going to be at a future time under what might be an entirely unpredictable tort system.

Mr. BEER. That is not only true with regard to their premium expenses, but it may be true for their own liability exposure. Anything that they in fact retain, they are working under the same constraints as the insurance industry, trying to expect what is a reasonable amount of insurance to even buy these days. So, yes, they are both confronted with the same issue.

The CHAIRMAN. I am told that day care centers cannot buy insurance. I do not know if that is so or not, but I am told that.

I am also told that there have not been a lot of claims on day care centers, but that the reason for the unavailability of insurance is that insurance companies do not want to insure day care centers because they cannot predict whether or not there are going to be huge future claims as a result of some of these awful stories everybody has seen on TV with respect to child molestation. Is that correct?

Mr. BEER. Yes. I believe other examples might be in municipalities and hazardous waste managers where essentially the loss experience to date has not been that bad, but the recent decisions, erosion of sovereign immunity that was referred to, interpretations by the courts into some situations where essentially the industry fears—and I should say, not only the industry but even the actual people bearing the risk, even if it is not through insurance—the concern that there is no limit to this deep-pocket theory, or essentially there does not seem to be any relationship between fault and awards.

Now these are views expressed by both the industry and the purchaser, but I think it is fairly uniform in that voice.

The CHAIRMAN. Now I do not want to see the Federal Government launch into whole new areas unnecessarily, but do you believe on the basis of your experience that in the areas of possible expansion of risk retention legislation and in the areas of tort reform these are areas that should be explored by Congress?

Mr. BEER. Yes; I emphasize the word "explore." I think any decision that has to be made would have to take all sides into consideration. In my opinion, there is no simple solution—and obviously that is a trite statement—but I do not think one Act will change that, nor do I think Federal regulation necessarily would have prevented what happened in the past. I think it would have been difficult to imagine the Federal Government stepping in in 1982 and telling companies to raise their rates 20 percent because they were too low.

So I do not think Federal regulation, per se, is the answer. Federal—I guess what I am leaning toward is more of a passive type assistance than an active type of assistance such as you suggested, passively allowing risk retention acts to facilitate those type of groups, and letting the buyers of the insurance products themselves decide what and how much they will buy.

The CHAIRMAN. Are there any further questions?

Senator HOLLINGS. You have provided us very valuable testimony, Mr. Beer. From your experience, do you observe that insurance companies are financial arrangements, and that it is fairly easy over the years actuarily to predict the mortality rate for life insurance. If we are all now living to 75 years of age, they are using about a 70-year age actuarial book back at their home office.

Now, in some cases, where you cannot get insurance, there is not a track record. Child care centers have been caring for the poor, and others, in order to help the women to work, and have been operating on their own and have not even thought of insurance. But now there are such examples as a grownup saying that a child care center was responsible for letting a child fall off the chair, and there is a verdict. So the insurance companies say, we do not have a track record for child care. We do not have a track record for city councils, because only recently has come the erosion of sovereign immunity.

I have not seen an insurance company operated properly that is not making money. This requires responsible underwriting.

In one way it is really a money game. We do not have an entity in here as you indicate, to regulate when rates are entirely too low, as you indicate. Is it a money game, the insurance operation?

Mr. BEER. Well, it is a bit more than a money game. There needs to be some underwriting. I think it might be a bit of a simplification to say that it is a money machine. Unfortunately, and I already rattled off some of the names of major companies that purchased insurance subsidiaries. By the way, you can take a look, in the late 1970's, at the peak and you can almost track these acquisitions.

Unfortunately, those insurance subsidiaries have had a profound impact on those earnings. I do not think those companies would agree.

Second, there are a lot of insurers out there who have policies that are worthless right now because the companies who issued those policies are insolvent and being liquidated by State insurance departments. So it is a lot more than just an arrangement to transfer funds.

There is definitely risk transfer, and some of those companies accepted much more risk than they ever anticipated.

Senator HOLLINGS. We have had a lot of companies go out of business, go bankrupt. This Congress is concerned about farms and bankruptcies, banks and the bankruptcies. We have had a lot of that in the insurance industry.

Mr. BEER. Yes; there were over 23, 24 companies who were declared insolvent last year, and a number of others that are being rehabilitated or liquidated at the present time.

Senator HOLLINGS. About how many now, do you know? How many companies are now being liquidated, approximately?

Mr. BEER. Thirty.

Senator HOLLINGS. About 30. How will that compare with last year? Are there more companies going broke, or less companies?

Mr. BEER. Just to give you orders of magnitude, starting in approximately 1982, and I did some work on this for another committee, it was essentially two or three in 1982, about eight or nine in 1983. There were about 18 in 1984, and over 20 in 1985.

Senator HOLLINGS. I see. And what is the projection for 1986, 1986–87?

Mr. BEER. The general feeling is that crisis is over, to use your phrase.

Senator HOLLINGS. There is a leveling off?

Mr. BEER. There will still be some fallout of that because a number of those companies insured some other companies. When the first domino falls, a number of other companies may fall. But it should not be anywhere near as severe as it was in 1984 and 1985.

Senator HOLLINGS. Thank you.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you——

Senator PRESSLER. Let me just ask one more brief question, if I may. That is, what steps can or should the insurance industry take to smooth out the historical cycles that appear to cause such dislocation in the economy? You have mentioned that there probably should not be Government interference, but yet these cycles seem to be blamed for the very high rates a lot of insurance buyers are paying the price.

Mr. BEER. This may sound like a paid political announcement for actuaries, but I think one of the problems, many people would admit, that in the early 1980's, as was suggested, actuaries did in fact indicate which rates were to be charged. Through a variety of management decisions, those rates were not charged. Nowadays I think you will see a lot more technical, financial, and actuarial people are rising into the company ranks.

I think the companies are essentially now paying more attention to each of those components that you highlighted: the investment income, as well as the underwriter income, separately as opposed to just riding the wake of the net income. So in that sense, I think companies are becoming more responsible with regard to underwriting judgment.

The CHAIRMAN. Thank you very much, Mr. Beer.

Our next witness is Ralph Nader.

STATEMENT OF RALPH NADER, DIRECTOR, CENTER FOR STUDY OF RESPONSIVE LAW

Mr. NADER. Thank you, Senator Danforth, Senator Hollings, Senator Pressler, for the opportunity to testify today on this problem. I hope some of the points can come out in the question period, but I will try to summarize the principal points I am going to make in a brief fashion.

We are here because Members of Congress have been beseiged by letters and calls from businesses, nonprofit concerns, municipalities, that they are experiencing either arbitrary cancellation or sharply increased premiums and/or reduced coverage. They also believe that they are being treated unfairly because they have very clean records.

Before State legislative inquiries, again and again these people will come and say, "We have not had a claim in 30 years, in 40 years, in 20 years, why are we being exposed to 800 percent increases, reduced coverage, and/or arbitrary cancellations."

That is really what has catapulted this issue. There are two ways to go on this issue. One, is to look at the insurance companies' practices and status; and the other is to look at the tort liability system. I think before we jeopardize one of the pillars of our economic democracy, the tort liability system, we should recognize what it gives us.

It gives us more than compensation for injuries. It gives us deterrence, which leads to reduced carelessness, saving more lives, preventing more injury, and preventing more property damage. It leads to disclosure. Many a time your colleagues have come on the floor of the Senate with evidence obtained from depositions, from court records, such as Senator Nelson did in the tire hearings which led to the Tire Safety Act of 1966. Those data came from the rigorous investigative and discovery procedures under our tort system.

Four, the tort system gives us an incremental expansion of human rights in this area. That is, the legal system's respect for the physical integrity of human beings of all ages from the harm and risks imposed on them by an industrial society. That is a very valuable system, I believe. I think it is the best one in the world. I think when some of us go abroad and we ask ourselves what are we most proud of in the United States, it is our civil liberties, civil rights, and safety rights, the respect for human beings' physical integrity, and the tort system is part of those safety rights.

The medical malpractice, Mr. Chairman, premium payout is about $2 billion a year. For that we get compensation, deterrence, disclosure, and an expansion of the rights of victims. That is about as much as we spend on potato chips and pretzels. Two billion dollars a year is less than 4 percent of physician gross income. It is less than $8 of the $1,550 the average person pays for all health care in the United States per year, and it is less than the post-tax profits of one company, General Motors.

Now given that system and what it delivers—and of course it can be improved, and court congestion can be cut down, it can become more efficient in the dispute resolution system and so on—but given that structure of rights, what are we confronted with in this so-called insurance crisis?

I think one is the cycle that Mr. Beer described. I think the second has not been sufficiently emphasized. That is, the role of the foreign reinsurance companies. We do not have insurance independence in the United States of America. We are one-half of the entire world's insurance market, and the strings are being significantly pulled by foreign reinsurance companies led by Lloyd's of London involving the Swiss, German, and other reinsurance companies.

Lloyd's of London sets the pace. Lloyd's of London has had problems which has prompted it to go berserk in trying to bring down our legal system in and its rights to the lowest-West European denominator, by going into one State after another and basically saying at conferences, if you do not change your tort system, we are going to withdraw.

Lloyd's of London has been, as the parliamentary inquiries and British press have reported, riddled with syndicate corruption inside its ranks for 6 years, many losses. It has had great property casualty losses. Last year was a terrible hurricane year, major airplane crashes, satellite losses, and it has also been hobbled in part because of currency exchanges.

Now none of those can be attributed to the liability crisis. It is a property damage crisis. It is an internal corruption crisis, and it is a problem of international currency, among others.

So I do not want to see us, because of foreign reinsurance running amuck, to jeopardize our tort liability system, especially since Lloyd's of London, Mr. Chairman, has never testified before a State insurance hearing in recent years as far as we know; it has not testified in Congress; it is not regulated; it is not required to disclose line by line whether its claims of losses are really verified.

Let me suggest that following recommendations at the Federal level, and there are others at the State level. The following recommendations include:

A collection of proposals that do not involve Federal regulation. They do involve empowering the receivers of the insurance system to define themselves. One is to eliminate the exemption from the McCarran Act under the antitrust laws for the insurance industry.

Two, is to facilitate self-insurance. It is interesting that in most States there are laws lobbied by the insurance companies years ago preventing group liability purchase, like group auto, group homeowners, group liability. They should be overridden.

Third, to develop a standby Federal reinsurance capability to send the signal to Lloyd's of London and their confreres. The Federal Government did this to deal with the innercity crisis in the late 1960's and early 1970's and made $125 million in profits.

And four, the Federal Government should require the appearance of Lloyd's of London and other foreign reinsurers to examine their role in this situation.

I would hope, Mr. Chairman, that also there would be proposals to empower insurance consumers according to the citizen utility boards that are now established for utility ratepayers in Illinois and Wisconsin.

And finally, I hope that the insurance industry would pay more attention to its loss prevention duties, not just lip service for reduced fires and reduces risks, but to take its political, economic muscle, its actuarial information and push for auto safety and chemical control safety and drug safety and hospital practice safety to keep its claims down. If it does this, I think it will go a long way toward reducing some of the liability claims that are coming up, and it will stop being a sacred-cash cow feeding the public a line of bull.

Thank you, Mr. Chairman.

The CHAIRMAN. Well, I am a lawyer, I guess still, a member of the bar, and I do not understand why lawyers should be a sacred cow either. I do not understand why the tort system should be a sacred cow. I do not share your ringing endorsement of the status quo in the tort system.

It seems to me that America is overrun with litigation, and that it is coming out of our ears, and that a system which has created over half of the recovery in lawsuits for lawyers where lawyers are pocketing more than half of the tort recovery is clearly crazy, and that there is plenty of room for improvement of our legal system.

Mr. NADER. Which is what I said.

The CHAIRMAN. What? That is not what I got from your testimony. I got a most ringing endorsement of the present legal system like that I get from the trial lawyers association.

Mr. NADER. Of the rights. You see, you have to carefully distinguish, Mr. Chairman, the rights respecting the health and safety and recovery of compensation from the way the system operates in administrating it. As I said in my testimony, there are many proposals that can be made to increase the efficiency of the system, reduce whatever gouging lawyers on both sides may be involved in, and the lawyers on the defense side take a bigger chunk because they get paid, win or lose.

But what I want to have respected on a pedestal equal with civil rights and civil liberties are the cumulation of 100 years of judicial decisions, some of them majestic in their content, respecting the physical integrity of individuals who are killed, injured, or exposed to disease because of the negligence or the product defects of others. That is what I would respect and hold inviolable.

The CHAIRMAN. I respect that, too. But what I do not respect is when somebody files a lawsuit and nothing happens for 10 years——

Mr. NADER. Agreed.

The CHAIRMAN [continuing]. And they are tied up in endless discovery, and have stacks of interrogatories to answer, and when it is all over they have recovered a very large amount of money, but most of it goes to their lawyers.

Mr. NADER. Agreed. We need to improve the efficiency of the system that respects these rights. However, the issue before us today, Mr. Chairman, are proposals to restrict these rights. I will submit for the record the analogy with Canada.

Canada has, and has for years, all the tort reforms, so called, that the insurance companies want in this country, and there is a crisis in Canada just like this country with premium increases, arbitrary cancellations, cities, municipalities, mass transit systems, hospitals cannot get insurance, and I have got the material there.

So that the so-called tort reform part of this overall problem has not worked to alleviate the insurance crisis in Canada, nor has it worked in Indiana. You see, what they are asking for—you see, you do not see any insurance companies coming up here, Mr. Chairman, and saying let us deal with the attorney chunk of this. They complain to me in private that the curve of their payout dollar that is going to their defense attorneys is up very sharply.

One company told me last year it reached 40 percent of their entire payout verdict settlements and legal costs. Now they do not come up and say let us take care of that. We can find common ground on how to improve the efficiency of the legal system that administers these rights.

What I do not want to see is, because of the industry's mismanagement, something recounted in the New Jersey Insurance Commissioner's statement, which I will submit for the record, Hazel Gluck, Republican appointee, I do not want to see the insurance industry's mismanagement and cyclical problems jeopardize the basic structure of rights in the personal injury system.

[The following information was subsequently received for the record:]

COMPARISONS BETWEEN "TORT REFORMS" SOUGHT BY THE INSURANCE INDUSTRY AND THE LAW OF ONTARIO, CANADA

In most of the 50 states, the insurance industry is seeking legislation that would make it more difficult for injured people to win lawsuits and would limit the amount of money they could recover if they do win. The law of Ontario, Canada (where the insurance industry is raising rates just as it is in the United States, see Chart 2) already contains the provisions the insurance industry seeks, as the following chart shows:

The insurance industry wants:	Ontario, Canada has:
A. Caps on compensation for pain and suffering — e.g., for quadriplegia or brain damage — typically of \$250,000.	A. Caps on compensation for pain and suffering. Ontario has a cap of \$100,00 in 1978 Canadian dollars (\$185,000 in current Canadian dollars). See Andrews v. Grand and Toy Alberta Ltd., 2 S.C.R. 229 (1978); Ontario Law Reform Commission Report on Products Liability, at 62 (1979) (hereinafter "Ontario Law").
B. Restrictions on punitive damages: e.g., limiting punitive damages to a specific amount or a specific multiple of the compensatory award, or absolutely prohibiting punitive damages.	B. Restrictions on punitive damages. In Canada, punitive damages are virtually unknown in tort cases. They are allowed only for intentional torts. Ontario Law at 75; Linden, Canadian Tort Law, at 49-51(1977).
C. A prohibition on injured people specifying the amount they seek in the complaint (in legal jargon, eliminating the *ad damnum* clause).	C. A prohibition on injured people specifying the amount they seek in the complaint. In Ontario, the plaintiff is not permitted to demand a specific amount in the complaint. See Gray v. Alanco Development, Inc., 1 O.R. 597 (1967); Ontario Law at 75.
D. Restrictions on contingency fees — e.g., by establishing a sliding scale that reduces the percentage of the award the lawyer can receive as the award gets larger.	D. No contingency fees. In Ontario, contingency fees are prohibited. Ontario Law at 72, 75.
E. Restrictions on the role of the jury — e.g., taking the authority to determine the amount of punitive damages away from the jury, or requiring the jury to answer detailed interrogatories that limit its discretion.	E. Restrictions on the role of the jury. There is no constitutional right to a jury trial in Canada. Most trials are judge trials. Ontario Law at 74, 102-04.
F. Penalties for "frivolous" suits — e.g., requiring the plaintiff to pay the cost of defending such a suit.	F. Penalties for "frivolous" suits. In Ontario, if the plaintiff loses he must pay the defendant's attorney's fees, as well as his own. Ontario Law at 72, 76.

The **Chairman**. Well, let me ask you this question. If the insurance industry is doing as well as you claim it is, and if it is gouging people, then why is it that the rate of insolvencies among State-regulated insurers is running at the highest rate since the information was first collected in 1969?

Mr. **Nader**. One, because——

The **Chairman**. And why is it that there are increases by physician mutuals and other insurance companies that are owned exclusively by their insureds? Why are they increasing their prices?

Mr. **Nader**. One, let us take your first one. One is that, as Mr. Beer said, there have been some companies with inexperience or mismanagement. Most of these companies that have gone belly-up are small companies. Some of them can be called fly-by-night companies. They ran their business in the wrong way. Savings and loans have done so, as well, in a period of tumult.

Second, your medical mutuals, you must realize that many of them are administered by private malpractice insurance companies. The Rhode Island one, for example, is administered by two private malpractice insurance companies. They do not even have a staff of their own, the Medical Mutual, and their actuaries have the same idea about loss reserves as a commercial malpractice insurance company.

But I have to tell you one illustration in responding to your question. In Rhode Island, and the same is true in Pennsylvania and Florida, less than 1 percent of the physicians account for about 24 percent of the payouts in the last 10 years in verdicts and settlements. The exact figures in Rhode Island, 11 physicians out of 1,700 physicians in Rhode Island accounted for 24 percent of the payout.

Now why in the world would not the medical mutuals in all malpractice companies experience-rate doctors so that the majority of the doctors who have not had a claim and have a clean record do not have to pay as much as the incompetent recidivist doctors whose licenses seem never to be revoked or suspended by medical licensing boards?

If they did that, they would be in even better shape than they are in now.

The **Chairman**. Senator Gore.

Senator **Gore**. Mr. Chairman, I apologize. I had to make a speech on the floor. I will withhold questions until I get back into the flow of the hearing. Thank you.

The **Chairman**. Thank you. Senator Pressler.

Senator **Pressler**. In the February 11, 1986, *Journal of Commerce* article which I would like to insert in the record by reference, you stated that various organizations and businesses in the Province of Ontario, Canada, are experiencing grave difficulties in obtaining insurance. You pointed out that this is despite the fact that the Ontario civil justice system has already enacted many of the tort reforms being called for in the United States.

You conclude, therefore, that there is no insurance crisis in the United States resulting from the tort system. But it is also my understanding that a number of European countries also have in place a number of tort reforms being proposed by the American insurance industry and others, and many of those countries' insurance premiums are considerably lower than those in either the United States or Canada.

Now in part the insurance industry seems to look at the North American market as a whole. Also, if one State enacts tort reform it does not help the people in that State, as has been pointed out in the hearing this morning, because the insurance industry sort of takes a nationwide view, and this perhaps argues for a nationwide approach.

But the fact of the matter is that if you applied your comparative analysis to the European example, is there not a strong argument for tort reform, if our goal is to reduce insurance premiums?

Mr. NADER. Well, Senator Pressler, I do not want to give the implication that these tort reforms are advisable. I do not think it is advisable to cap pain and suffering. We do not cap insurance executives' million dollar salaries incurred without pain and suffering. I do not believe in eliminating punitive damages. I do not believe in eliminating contingent fees, which open the courtroom door to impecunious people. I do not believe in restricting the role of the jury to reflect the values of the community about what injuries or human life can be worth in terms of compensation.

I am just saying that what they are demanding in your State and other States they have had for years in Canada, and they are performing the same way. You know why? One reason why——

Senator PRESSLER. No; but my question is, What about comparing the European system?

Mr. NADER. I do not want to, because we are so far ahead of it, Senator, just like——

Senator PRESSLER. But their rates are much lower.

Mr. NADER. But we are so far ahead in respecting the health and safety rights in the courts of law. It is virtually impossible to win a product liability suit in Europe. You are not tried by a jury of your peers. You have to pay the opponent's legal costs if you lose.

Senator PRESSLER. I am not arguing that. I am just saying that insurance rates are much, much lower in Europe. So if we are going to make a comparison with a foreign country as you did with the Canadian example, you are saying then you would agree that the reason they are much lower in Europe is because the tort system is different.

Mr. NADER. There are many other things. A lot of them are State insurance companies, number one. They are state insurance companies. They block the personal liability route in favor of a codified workmen's comp type route. They are just so far behind in adapting the law to the perils of new technology.

Senator PRESSLER. Well, all right, but the point I am trying to make is that in the *Journal of Commerce* article you used the Ontario, Canada, comparison where it suited your purposes, but the European example tells a different story, I think you would agree. You say that they do not have the same rights we have. You cannot bring a suit as easily. That is part of what tort reform would be about, I suppose.

So you would agree that in Europe part of the reason for lower insurance rates is because some of these things that are called tort reform, or tort differences, exist?

Mr. **Nader**. Well, first of all, let me just make it clear that they have a civil law system, except for England. I want to compare common law countries. Canada is a common law country that comes closest to our country with these exceptions in terms of the way they adjudicate claims.

Senator **Pressler**. But still, would you not agree that part of the reason the European rates are lower is because of a tort system that is different?

Mr. **Nader**. I have not studied how low European rates are, Senator, in answer to that question. I mean, that is an open question.

Senator **Pressler**. Well, after you have studied it, maybe you could answer it for the record.

Mr. **Nader**. Have the Federal Trade Commission inquire if it gets permission by a committee of Congress to investigate the insurance industry.

Senator **Pressler**. Now let me ask you this. I think you did an outstanding job of leading consumer groups in the 1960's, but I have come to believe that the leading consumer issue of the 1980's and 1990's may well be insurance rates, this whole thing we are talking about, because it makes products so much more expensive, makes it so much harder for individuals, and for small companies to operate, whether it is a day care center or a small business or whatever. I believe that this is a leading consumer issue, because I think every American has an interest in getting the rates down.

And as I said in my opening statement—I do not know if you were in the room or not—I am capable of being equally critical of the insurance industry——

[A bell rings.]

Senator **Pressler** [continuing]. Is that a bell on me, or something else?

The **Chairman**. Something else.

Senator **Pressler**. I think we need to look into what the insurance industry is doing, and the questions I have asked this morning have been much harsher on the insurance industry than on our court system.

But everywhere I go in this country, consumers say we must do something about the number of lawsuits. I say that as a lawyer, as a graduate of the same law school you are. Were you proud of the spectacle of our trial lawyers going to Bophal seeking contingency fees, or that sort of thing? Is that a thing that the legal profession can be proud of?

Mr. **Nader**. No. Both sides went, as you know, some to try to get releases, and some to try to get assignments, and it was a disgraceful performance. It was a disgraceful performance the way it was done.

Senator **Pressler**. But that is——

Mr. **Nader**. But that does not mean that there should not be a system to inform those unfortunate people in Bophal that they may have legal rights to sue in the United States. But it was done in a disgracefully flamboyant way.

Senator **Pressler**. As you are a representative of consumers, I would say the majority of consumers want some type of legal reform. Why are you opposed to that so strongly?

Mr. NADER. I will debate anybody on the opposite side of that issue before any audience. If I do not win three to one hands down, I will concede defeat.

This country is not overrun with litigation. Prof. Mark Gallant through his comparative studies with Europe and Australia and Canada, the American Bar Foundation inquiry, and other studies have shown that our per capita civil use of our civil litigation system is not extraordinary. There is no evidence that verdicts and settlements in the liability area have done anything more than barely keep up with inflation and population growth in the last 20 years. The Rand Institute for Civil Justice has stated that. Remember, the dollar is worth like 35 cents of what it was worth in 1969.

So it is very easy to take a few anecdotal examples, many of which are distorted in their facts, and we can go into that if you would like, and say the system has run out of control. There are about a half a dozen studies that point to one central fact in medical malpractice. Only 1 out of 20 people who are victims of medical malpractice get any money.

Senator PRESSLER. Who does get the money? It is usually the lawyers, when there is a recovery. Let me add that I think we have to proceed in this hearing somewhat critical or analytical of both the insurance companies and the legal tort area.

Let me ask you this: Is there any area of tort law or the practices of lawyers that you would suggest reform in?

Mr. NADER. If we can show that there is no other way to control rates, I would cap the contingency fee at one-third.

Senator PRESSLER. You would cap the contingency fee at one-third.

Mr. NADER. At one-third. Remember, they only get it if they win. But I would also control the defense lawyers' hourly fees, defense lawyers who have vested interests in overcomplicating and delaying because their meter is ticking all the time. Just ask the insurance companies' in-house lawyers about that.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. On that particular score, Mr. Nader, that should be clarified. Would you elaborate a little there? In other words, the question by the distinguished chairman was to the effect that lawyers are not sacred cows. There is endless discovery where cases are tied up for 10 years. Would you differentiate from the defendant's lawyer who would have an interest in endless discovery, who would have an interest in extending it for 10 years, or the plaintiff's contingency fee lawyer who has his own money tied up and wants to bring the case to court. The plaintiffs lawyer wants to get a trial and wants to get a conclusion because he cannot afford to finance the case much longer.

I think the record ought to show who have been the sacred cows. Would you elaborate for us, please.

Mr. NADER. Well, as between lawyers who represent the victims and only get their fee if they win, compared to lawyers who represent alleged perpetrators and get their hourly rates whether they win or lose, the biggest problem is with the defense bar.

The plaintiff's bar opens the door. You cannot get into the courtroom door unless you have a lawyer willing to risk, as you say, his or her overhead in filing the suit. That is also a safeguard against frivolous suits. So I think that the bigger problem is the defense counsel.

I think a lot of important material comes from depositions and interrogatories. They are not all harassment on either side. There is some very important data that can be sent over to the medical licensing boards of the 50 States so they can do their job better. But I think there should be more severe crackdowns on frivolous delay by the courts.

I think that there should be improvement in efficiency in the judicial system. You know, in some parts of the country they have speeded up these court cases. I remember once 24 years ago in Miami they went from 5 years' delay to 1 year's delay. So there are ways to improve the efficiency.

Prejudgment interest helps speed up these court dockets, and only about less than half the States have prejudgment interests. Without prejudgment interest, the insurance companies have a vested interest in delaying, because they are earning interest on that money that they may eventually have to pay out.

Senator HOLLINGS. Now we are beginning to see who is the sacred cow. Right to the point, I was with this weekend a distinguished Federal Judge, a good Republican appointee, and I told him we were going to have these hearings. I said, how are things at home? And he is known to be a very conservative judge. He said, you do not have any trouble in South Carolina. There are not any runaway juries there.

We are hearing extremes with respect to trial lawyers and different verdicts obtained. That does not say anything about the so-called settlements after the defense lawyer has milked it, and interrogatoried it, and discovered it, and delayed it, and continued it. Then when defense lawyers actually have to go to the trial, they may advise paying out too much to avoid that trial. That has been my experience.

Tell us something about Canada. That interests me, because we have got a stampede now for tort reform. Did you say they have had tort reform and yet it has not reduced costs?

Mr. NADER. I prefer to call it tort deform, but here is what Canada has. Let us take Ontario, which is the closest analogy to our legal system of all the other provinces, Quebec being somewhat more remote from our common law, so let us take Ontario.

They have in Canadian dollars a cap on compensation for pain and suffering of $185,000, even though all pain and suffering is not created equal. They have restrictions on punitive damages.

Senator HOLLINGS. Well, let us talk about pain and suffering. People in the audience would not know how to measure it, but take one of the *Dalkan Shield* cases where, quite to the point, you lose your chance to reproduce. Now the housewife, is not losing earnings due to her injury, so her actual economic losses may be nothing. The interuterine device is defective and has really injured the individual and the poor woman can no longer reproduce. Should not there be pain and suffering damages for that particular loss?

Mr. NADER. Yes. The same would hold true for children who do not hold paying jobs.

Senator HOLLINGS. Well, I just wanted them to understand what you are analyzing when you discuss caps on pain and suffering. Continue, please.

Mr. NADER. Restrictions on punitive damages, which are virtually unknown, for reckless disregard—that is a situation let us say similar to a Pinto fuel tank coverup, or the asbestos coverup; a prohibition on injured people specifying the amount they seek in the complaint. That is putting down that they want $1 million, $2 million, whatever. That is prohibited. They have to leave it blank.

There are no contingency fees in Ontario. They are prohibited. Therefore, if you want to sue General Motors because of a stuck throttle when the car lurched forward and went into an abuttment and you are injured, if you cannot take on General Motors with all its lawyers and expert witnesses and all its deductible expenses, with your nondeductible expenses, and if you lose against General Motors you have to pay General Motors' Covington & Burling legal fees and its costs. That is about as great a deterrent to blocking the courtroom door as if a sheriff stood in the way with his arms folded.

Restrictions on the role of the jury. There is no constitutional right to a jury trial in Canada. Do you know how rare it is in our country to have these decisions made outside of a codified system? The labor unions now are weak for other reasons. They are not pitching on health and safety. The antitrust laws are not being enforced. Federal regulation on health and safety has declined very dramatically.

What is left besides the tort system to signal accountability, deterrence, generate disclosure and compensate victims? It is the only thing that is not responsive to PAC's, isn't responsive to bureaucracy of some corporation or labor union. It is something we should treasure, instead of constantly harping at in terms of overlitigation and litigiousness.

Senator HOLLINGS. Well, let me congratulate you. I can categorically state that you have saved lives. You have established safety rights, Mr. Nader, and I appreciate your testimony, and I hope we get some more time later on on another occasion. Thank you very much.

The CHAIRMAN. Senator Gore.

Senator GORE. Mr. Chairman, I wanted to give the witness an opportunity to complete the response, because I felt that he was headed toward a comparison of the experience in Ontario with the experience in the United States, and toward a conclusion that in spite of all these limitations on the tort system in Ontario, the result with respect to insurance rates was not markedly different. Is that where you are headed?

Mr. NADER. Well, Senator, for example, marked parallels in the literature indicate what I am going to say in greater detail. The insurance industry has refused to provide insurance for Ontario day care centers. Sound familiar? The insurance industry has refused to provide liability insurance for Toronto, a city, and many other cities. It has raised premiums a thousand percent to reduce coverage for the Ontario innercity bus industry. And it has renewed the Ontario School Bus Operators Association policy on December 1 by 400 percent more than it charged the year before.

There was a survey done in Colorado of day care centers to show you why Senator Pressler's inquiry was so seminal earlier, demanding disclosure of how much they are paying out and how much they are taking in and so on, they surveyed day care centers and they reported back, 156 reported back that over the last 10 years the total payout was $55,000. The total premium pay in was $1 million.

Now one might refer to Senator Hollings' question of why are not other companies going in. No. 1, it is not so big a deal. It is only a $4 million industry. So it is not like really big and lucrative.

No. 2, it takes awhile to get into a specialized line. No. 3, why should a new company want to come in when they know very well that the companies who are withdrawing are going to come back in and pull the rug from under them once this cycle is over. And No. 4, they will not insure your apple tree, Senator, unless they get reinsurance. And if Lloyd's of London says day care center, that is peanuts for us, we are not going to reinsure, crashing down goes the day care center coverage.

That is why the Lloyd's of London approach—excuse me, the Lloyd's of London inquiry is so important for the committee to engage in.

Senator GORE. Well, I appreciate your response. Just one other question. I do not want to take my full time, but I understand you have made a number of statements about the reinsurance industry, and Lloyd's in particular. You were here when Mr. Beer made his presentation, and part of it, including one of his charts, seemed to make the point that the trade ratio performance of the reinsurance industry has been even worse than that of the primary insurance industry.

How do you react to that? How do you reconcile his findings with your charges with respect to the reinsurance industry?

Mr. NADER. Senator, I do not know how he knows that. I can see how in the aggregate Lloyd's can lump in their hurricane losses, their airplane crashes, their currency exchange problems, and come to that conclusion, but we are talking about commercial line-by-line disclosure. And Lloyd's is pulling the rug out from officers and directors' insurance in corporations. They have refused to disclose how much they have taken in, what their investment income is, how much they have paid out in verdicts and settlements, and where the rest is going.

Mr. Beer, although he was intent on trying to supply Senator Pressler and the committee this information, is going to have a hard time breaking it down commercial line by commercial line.

Senator GORE. All right. Well, thank you very much, Mr. Chairman.

Senator PRESSLER. Mr. Chairman, I would just like to follow up.

The CHAIRMAN. Bearing in mind that we have 12 more witnesses, and it is 20 to 12, Senator Pressler.

Senator PRESSLER. I will bear that in mind.

Would you provide for the record an analysis of why the European rates are so much lower than ours? And let me say in asking that, this morning I think the record will show that I have been very tough in the questions I have asked the insurance industry. You virtually let the trial lawyers off scott free.

A second question that I have, not for the record but here, is: Given that the largest share of tort costs go to attorneys under our current system, it seemed to me that the lawyers are the big beneficiaries, while the plaintiffs get precious little, and the vast majority of consumers end up paying the price in higher product and service costs, as well as higher insurance premiums.

Would you not agree that the current system primarily benefits the lawyers at the expense of consumers in providing equitable relief to the injured plaintiff?

Mr. **Nader**. Senator, you are asking me what I want as a system. This is a free enterprise marketplace. You are the guys who are always promoting it. Now you do not like it.

I mean, I can design a system that I think would come close to being much fairer with the lawyers getting less, but you do not want that. You do not want price control on lawyers. You do not want it on architects, on engineers, on doctors.

I am saying that if you accept the system, the lawyers tend to expand the pie. You see, in other words they do take a chunk, but they expand what that plaintiff gets enormously because that is the way the system operates.

Senator **Pressler**. But my question is about the fact that lawyers currently get the biggest chunk of these recoveries, and that is what troubles me. Does it not trouble you? Does that not trouble you?

Mr. **Nader**. Yes; it does, together. Together they get the biggest chunk, yes.

Senator **Pressler**. Now can you provide for the committee any solid evidence that the insurance industry is creating or exploiting the current insurance crisis to blackmail Congress or State legislatures into tort reform as you have charged in the press?

Mr. **Nader**. Oh, sure. I will submit that for the record. In fact, if you want I will flood your office with business policyholders complaining about how their perfect record for 30 years has led to their cancellation of policies. I will be happy to do that.

Senator **Pressler**. That is really not the question I am asking.

Mr. **Nader**. Well, that is evidence. That is evidence. But I will respond to your question.

Senator **Pressler**. Thank you, Mr. Chairman

The **Chairman**. Now we have a time problem with one of the later witnesses, so we are going to shuffle the order a little bit. This panel will include Mr. Richard Berman, representing the U.S. Chamber of Commerce.

Then, Mr. William McCormick, Fireman's Fund Insurance Company; Mr. Stephen Martin, Hartford Insurance Group; Mr. Bradford Mitchell, Harleysville Insurance Co., chairman of the National Association of Independent Insurers; and Mr. Christopher Mansfield, vice president and general counsel, Liberty Mutual, representing the Alliance of American Insurers.

I understand that Mr. Berman has a particular time problem, so Mr. Berman, if you would like to proceed.

STATEMENTS OF RICHARD B. BERMAN, EXECUTIVE VICE PRESIDENT, PUBLIC AFFAIRS AND HUMAN RESOURCES, S AND A RESTAURANT CORP., REPRESENTING THE U.S. CHAMBER OF COMMERCE; WILLIAM M. McCORMICK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FIREMAN'S FUND INSURANCE CO.; STEPHEN I. MARTIN, VICE PRESIDENT, HARTFORD INSURANCE GROUP, REPRESENTING THE AMERICAN INSURANCE ASSOCIATION; BRADFORD W. MITCHELL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HARLEYSVILLE INSURANCE CO., CHAIRMAN, NATIONAL ASSOCIATION OF INDEPENDENT INSURERS; AND CHRISTOPHER G. MANSFIELD, VICE PRESIDENT AND GENERAL COUNSEL, LIBERTY MUTUAL INSURANCE CO., REPRESENTING THE ALLIANCE OF AMERICAN INSURERS

Mr. BERMAN. Thank you, Senator Danforth, Senator Gore.

I will take note of your admonition on the time and, as quickly as I can, summarize the essence of the U.S. Chamber's position in this area, sir.

I am executive vice president of S and A Restaurant Corp. in Dallas, TX, and I am also chairman of the chamber's civil justice action group, which is intensely involved in looking at this problem on a State-by-State, as well as a Federal basis.

I am cautioning myself not to restate everything that you have heard, and everything that the people here in this room are no doubt aware of based on their presence here. I would almost like to summarize my remarks by suggesting to you the chamber survey of businesses around the country as to just what the extent of this problem is.

Overall, we have found that over 40 percent have had premium increases of between 100 to 500 percent; nearly 10 percent had increases of over 500 percent in the last year in their insurance premiums. General liability coverage presents the greatest problem, 60 percent, followed closely by product liability, officer and director, 31 percent, and transportation liability, 30 percent.

The CHAIRMAN. Let me just interrupt you for a second, Mr. Berman. My hope was that this was the rest of panel two, that all of panel two would be joining Mr. Berman so we could receive all the testimony, and then question the witnesses as a panel. So if the other members of panel two could join Mr. Berman while he is presenting his testimony, I would appreciate it.

Please continue, Mr. Berman.

Mr. BERMAN. Perhaps the most frightening thing, and I have heard this personally as well as having the survey bear it out, is that 35 percent of the respondents suggested that they are considering or are in fact going without insurance totally and thereby risking bankruptcy off of one suit in many cases.

These are people who cannot afford the insurance premium that has been suggested to them by their carrier. We have asked people what their perception is as to why they are experiencing some of these claims. So many of the people, in fact 93 percent have suggested that they are dealing with frivolous claims in many situations.

I have some anecdotal evidence for you which I did not intend to give, but again in the interest of brevity I will substitute that for some of the other testimony I was going to offer this morning. My own company recently was involved in a lawsuit where a patron had been in a restaurant, to our knowledge had only had two drinks, had left the establishment and had an automobile accident.

There were no serious injuries. He only injured himself to a slight degree. A good Samaritan stopped alongside the road. Before the good Samaritan could get out of his car to help the so-called victim, another truck coming down the road hit the good Samaritan's car causing an injury to the occupant and his son.

That individual now has filed a major lawsuit against my company claiming that were we not to have served that first individual a drink, he never would have had the accident, therefore he never would have stopped.

We can afford to take on those kinds of claims, but in fact an individual who operates a small business cannot. That is really what is happening to the judicial system. We have opened up the system to a lot of frivolous lawsuits without any downside. Mr. Nader spoke about the fact that in England you might have to pay the other side's court costs or their attorney's fees if you should lose the case. We have no risk like that for people in our society who are willing to file frivolous lawsuits, and there is essentially no downside to any lawsuit.

As long as you have an attorney who is willing to take it on a contingency fee basis, you can do anything you want as far as the legal system is concerned.

Mr. Nader also suggested that this committee should take note of the fact that there are 100 years of case decisions that we should respect and hold involiable. I would remind the committee and Mr. Nader that if you go back 100 years, there was a concept of contributory negligence in our society. And under the theory of contributory negligence, if you were partially to blame for what injury occurred to you, you would not recover.

Now we do have in many States a more, I would think a more humane form of dealing with individuals who are slightly negligent in some of these situations. We have a theory of comparative negligence. So if you are 10 percent responsible for an accident or for a situation that occurred to you, then perhaps 10 percent of the recovery was on your ticket and you could only seek 90 percent of the damages that you incurred.

Unfortunately, most of the States are not in that situation. What we are dealing with today through judicial activism, through expansion of the legal system to redress almost any wrong, is a theory called joint and several liability. And so now you can be responsible for one, two, three percent of the situation that resulted in an injury and still be held for 100 percent of the damage because you may be the only one with any insurance or assets.

Now I am not claiming that there is not some support for Mr. Nader's arguments and some others' about the insurance industry and their premiums. I am not in a position to suggest to you that the premiums are set properly. But there is in fact, based upon our survey, talking to our membership, there is in fact a host of changes that need to be made in the legal system today if we are going to properly address the plaintiffs as well as the defendants rights in the system.

The CHAIRMAN. Thank you, Mr. Berman. Mr. Mansfield? I'm sorry, Mr. McCormick, as the names appear on the list.

[The statement follows:]

STATEMENT OF RICHARD B. BERMAN

I am Richard B. Berman, Senior Vice President-Government and Labor Relations of S & A Restaurant Corporation of Dallas, Texas. I am appearing on behalf of the U.S. Chamber of Commerce, the world's largest federation of business companies, chambers of commerce, and trade and professional associations. As Chairman of the Chamber's Civil Justice Action group, I am grateful for the opportunity to testify on the availability of insurance, which is a matter of enormous concern to the business community. It is a pleasure for me to be here.

An unprecedented liability crisis in this country threatens the vitality of American business and the health of our national economy, as well as certain fundamental social objectives. While the present insurance crunch causes severe hardship for businesses, professionals, and local governments, it shows no signs of abatement. Small businesses are suffering especially. They are unable to self-insure, set up captives, or exercise other options that are available to larger companies. Neither do they have the bargaining power to negotiate a more favorable deal with insurance underwriters.

Recognizing this need, the Chamber's Council of Small Business called for the formation of an "Emergency Task Force on the Liability Crisis." Acting on The Task Force's recommendation, the Chamber's Board of Directors authorized the Chamber to initiate a broadly established public awareness campaign, to educate the public on the causes of the present crisis, and to seek solutions to the problem of obtaining affordable insurance. A listing of other Chamber activities on the "liability crisis" is attached to the end of my testimony.

We all have heard by now more horror stories than we wish to recount on how this liability crisis has affected various segments of the American economy. As information has been pouring into "The U.S. Chamber's National Clearinghouse on the Liability Crisis," we can begin to understand the scope and depth of this crisis. We now know that these horror stories are not isolated and "anecdotal" and entire industries have suffered.

Perhaps, the most important information gathered by the Clearinghouse to date has been the preliminary results of a "Business Liability Survey." The Chamber, through its Clearinghouse, has undertaken an extensive survey of its members to determine the impact of higher premiums and in some cases lower coverage in their liability insurance policies. The survey is an ongoing process, and additional responses are anticipated; however, we do not anticipate that the findings will change significantly.

Allow me to share with you some of the highlights of our survey. First, the survey of U.S. Chamber members indicates that businesses in every region of the country have experienced hardship in obtaining affordable insurance. We have found that almost 20 percent of the businesses surveyed have not been able to obtain or renew their liability coverage. We believe when almost one of every five businesses cannot obtain liability insurance, there is genuine cause for alarm.

Overall, over 40 percent have had premium increases of between 100 to 500 percent, and nearly 10 percent had increases of over 500 percent. General liability coverage presents the greatest problem (60%), followed closely by product (40%), officer and director (31%), and transportation (30%). Nearly 35% are considering "going bare"—operating their businesses without any liability coverage at all.

Unfortunately, an incredible 95% believe the problem will become worse.

The survey continues by exploring opinions on the current state of the civil justice system. When asked why they belive the number of liability suits and damage awards is increasing, 93 percent said the civil justice system encourages frivolous claims, while 84 percent believe that liability is based on the ability to pay, not on wrongdoing. Ninety-six percent believe the size of awards is excessive in relation to the economic costs arising from injury, and 90 percent believe the number and outcome of claims against their business are unpredictable.

The final question we asked is "which of the following approaches should the Chamber of Commerce pursue concerning this problem? The answers were: 39 percent for civil justice reform; 63 percent for federal product liability legislation; 23 percent for tort reform; 42 percent for changes in insurance laws; and nearly 48 percent for all of the above. Interestingly, the last choice was "no action," and only one person checked that response.

These survey findings confirm in greater detail the recommendations from the state meetings preceding the White House Conference on Small Business. Two of the three leading recommendations concern this issue. The number one recommendation of the first 27 state meetings is tort reform, and product liability reform is the third leading recommendation.

But the figures are even more dramatic when we consider them on an industry-by-industry basis. The percentage of those not being able to obtain insurance is much higher in the manufacturing industry, where it is an astounding 30%. One-third of the manufacturers responding to the survey state that insurance premiums have increased between 100 and 500 percent. As a result, one-third of the manufacturers responding believe he higher premiums have led to decreased profits.

In the transportation service industry, almost one-third of the respondents claim to have increased prices as a result of the insurance crunch. At a time of great distress for agricultural producers, over 40% will have experienced decreased profits as a result of this crisis.

Likewise, over one-third of petroleum producers responded that premium price increases have led to decreased profits for their firms. One-fifth of all retailers responding say they are dropping products or services as a result of the inability to obtain insurance.

It has become apparent that the lack of affordable liability insurance and the lack of insurance altogether are largely the result of a more general "liability crisis," which manifests itself in many different ways. Our survey results indicate that the public recognizes this cause-and-effect relationship. And, while the lack of affordable insurance is certainly a very visible symptom of this crisis, there are others that are equally important. Other symptoms of the liability crisis include the explosion of law suits which characterize our legal system, the abandoning of certain products by manufacturers, decisions to file for bankruptcy by large corporations due to enormous liability exposure, and withdrawal by many from medical, accounting, and engineering professions.

I mention these other symptoms of the liability crisis not to diminish the magnitude of the insurance crunch, for surely this is alone potentially crippling. But, even if liability insurance were somehow magically made available to all those who wanted it, the corporate bankruptcies would continue, product prices would increase and professionals would flee from their chosen professions under the threat of a system which is increasingly encouraging litigation and outrageous awards. Only when logic is incorporated into the civil justice system will some of these problems begin to correct themselves.

Neither does awareness of the underlying inadequacies of our judicial system imply that short-term solutions to the insurance crunch should not be pursued. Although we recognize the enormous need for changes in our civil justice system, we should encourage insurance underwriters, as well as the state regulating bodies which traditionally have guided the industry, to develop programs that would ensure that all types of businesses have access to liability insurance coverage. We are encouraged that some states have successfully initiated "marketing assistance plans" and have created pooling arrangements under the guidance of state regulatory agencies. Similarly, we support the efforts of specialty trade associations to provide insurance coverage through programs that they have developed for their members, as well as the efforts of some businesses to self-insure or set up "captives."

However, we also recognize that these measures, like band-aids, are but stop gaps, which provide some necessary relief in a time of great need. But they cannot plug all the holes that a judicial system gone berserk has created. The notion of "compensation without fault" encourages actions against "unidentified defendants" and "deep pockets defendants"—i.e., businesses, utilities, cities and counties—which often become defendants in law suits because they can afford to pay or have insurance rather than because they are at fault.

As a consequence of the public expecting all damages to be paid by someone, regardless of fault, my own industry—the hospitality industry—has had to stand as a ready source of revenue in many cases for accident victims regardless of fault. State dram shop laws, which hold restaurants liable for injuries that result from serving beverage alcohol, are confusing and ambiguous. As a result of increased exposure to liability, without affordable insurance, many business men and women have closed rather than face a bankrupting frivolous law suit.

Tort and civil justice reforms are critical to the solution of the crisis that American businesses, professionals, municipal, and local governments face in obtaining and affording liability insurance. And there can be no substitute for enacting needed judicial reforms, which would better enable insurance underwriters to predict the exposure to risk on which they base their rate-making. The often cited product liability horror stories of which we are so familiar, where plaintiffs recover enormous sums based on jury sympathy or doctrines of deep pocket and strict liability, lead us to ask if it is any wonder that insurers are unwilling to offer coverage for activities for which they cannot predict the risk?

The Chamber is encouraged that there appears to be a genuine grass-roots movement across the country which supports reforming our judicial system. Over one thousand business representatives met simultaneously in town hall-type meetings sponsored by the Chamber in six cities last month. They learned from one another that their businesses were not alone in facing this liability crisis. Neither are they alone in seeking solutions. We know, through information submitted to the Chamber's Clearinghouse, that over half of the states have strong and growing coalitions seeking reform of our judicial system. We applaud the formation of such organizations, and it is our hope that they can benefit by working closely with the Chamber's Clearinghouse. Within the next two weeks, we will make available a listing of these coalitions to interested individuals and businesses that wish to join in this effort.

Creating a climate that would allow changes in the judicial system to occur is the goal of the Civil Justice Action Group and of coalitions working with it. Changes in our judicial system urgently are needed at both the federal and state levels of government. Although we are encouraged that this Committee is holding these hearings on insurance availability, as well as product liability hearings in the near future, we previously have expressed our disappointment over the failure of the Committee to pass the "Product Liability Act" last spring. A uniform federal product liability bill would go far in alleviating the present liability crisis which underlies the problem of insurance availability. We reemphasize our desire to see this Committee pass a product liability bill as quickly as possible.

The Chamber also is working to foster state tort reform with respect to medical professional liability. As it applies to health professionals and institutions, the present civil justice system is threatening the quality, availability, and affordability of health care in the United States. Our poll of "Nation's Business" readers and soon-to-be-released studies by the U.S. General Accounting Office reveal a broad consensus that everyone - health care provides, insurers, consumers, government, and business - are ill-served by the medical liability system. In June of 1985 our Board approved a medical tort reform program, including state action to cap awards for noneconomic losses, require coordination of payments from multiple sources, pay large awards over time rather then in lump sum, and encourage filing of law suits within a manageable time after the discovery of alleged malpractices.

The Chamber enacted policy last week that recognizes the need for judicial reform, as well as the cause-and-effect relationship between the inadequacy in our court system and the availability of insurance.

It recognizes that, in recent years, there has been an explosion of litigation, especially tort litigation, in the United States that threatens fundamental judicial objectives of deterrence and redress. Courts have consistently redefined substantive and procedural law to permit easier recovery of larger and larger amounts of damages, which often have little relationship to the economic loss suffered. This has created a patchwork of inconsistent and often contradictory state laws. Contingent legal fees are a powerful incentive for initiating and continuing litigation. Costs associated with litigation have escalated. Litigation has, in fact, become America's equivalent of a national lottery. In such an environment, the predictability that is required for profitable business operations and rational insurance rate setting has vanished. As a consequence, liability insurance has become unaffordable or unavailable to many businesses.

There is an urgent need to reexamine the premises of the litigation system. The business community, its chambers of commerce and trade and professional associations, must join together to restore rationality to the system so that it can operate more efficiently and fairly. Such a program of reform would, among other things:

Develop uniform standards of liability that are consistent with the principle that those who are responsible for harm to the person or property of another should, to the extent of that responsibility, offset the harm they have done.

Reform rules of damages, particularly as they relate to noneconomic loss and punitive damages.

Provide for alternatives to lay determinations of complex medical, scientific, and technological issues.

Develop fair and cost-effective alternative mechanisms to replace private litigation for dispute resolution.

Reduce transaction costs by regulating contingent legal fees.

Unless needed judicial reforms are enacted, this crisis will reserve ultimately its harshest consequences for American consumers. When obstetricians withdraw from their profession, it is the quality of health care for all of us that suffers. When sporting goods manufacturers go overseas, it is the American worker who becomes unemployed. And when, as many businesses reported to the U.S. Chamber, firms increase prices primarily to cover rising insurance costs, it is all of us who will pay more.

In fact, consumers as well as businesses already are beginning to feel the effects of the liability crisis. A growing number of corporations in an attempt to limit liability are abandoning certain products and, thus, deprive consumers of the benefits of technological advances. Important vaccines, drugs, and medical equipment in the U.S. are becoming "endangered products." As a representative of Lederle Laboratories explained to a special Chamber liability crisis meeting in Chicago recently, they are the only maker of the oral polio vaccine. Two other companies have ceased production of the vaccine. Yet, this is but one example of a trend that the Chamber survey indicates could be much more far-reaching. Services that are being eliminated have no bounds, and many are considered essential. They include health care services, day care services, and transportation services for society's most dependent.

The present liability crisis also has the potential to be devastating to the American worker. Large manufacturers with high risks of liability are considering limiting their sales to overseas markets, where different legal systems permit consumers to assume more risks than in the U.S.

At the very least, we can expect consumer prices to increase as a result of skyrocketing insurance premiums. In the construction and contracting industry, almost one-half of the businesses responding to the Chamber's survey indicated "increased prices" as one effect the liability crisis has had on their firm. Almost one-third of the professionals responding indicated the same answer.

Mr. Chairman, therefore, we are very concerned about the detrimental effect this crisis portends, not just for business but for consumers as well. Based on information compiled in our Clearinghouse, it is difficult to imagine that either group could withstand extended periods of hardship, which they are undergoing now. We hope that the present groundswell of support for tort reform can be translated into laws enacted by Congress, as well as state legislatures.

Overall, we urge this Committee to seek solutions to the underlying problems within the judicial system so that the problems for American business and consumers, which I have outlined, will not become worse. Thank you for the consideration of our views—I will be happy to respond to any questions.

Mr. McCormick. Thank you, Senator Danforth. I am the chief executive officer of Fireman's Fund Insurance Cos. and, although I have spent many years in business, I am a relative newcomer to the insurance industry. I used to be president of the American Express Travel-Related Services Co. I hope you all carry the American Express Card—and only entered insurance 2 years ago when Fireman's Fund, which was at that time a subsidiary of American Express, got into serious financial trouble.

American Express asked me to go out and take over Fireman's Fund when the losses surfaced. I think that puts me in a little different position than most people who are testifying, in that I come at the issues facing the insurance industry with a fresh eye, yet I have been in this business long enough to have developed a good grasp of them. So I welcome the opportunity to shed some light on these issues.

I might say at the outset that, I, like you, receive mail from people who cannot get insurance, including members of my own board of directors, whose rates we have had to increase 200 and 300 percent in order to remain financially viable. It has not been an easy time.

I came to this industry with the strong belief that unprofitable businesses cannot survive. Insurance companies, like banks and other fiduciary financial institutions, must protect their financial strength, and therefore, must have conservative accounting and be profitable or they cannot meet their ultimate requirement, which is a promise to pay—usually in the future.

I want to make some quick observations about the industry, just for perspective. One is that the insurance industry is clearly big and important. It is the second largest industry in the country, and it is obviously essential for commerce. Credit cannot be granted in many cases without underlying insurance to protect the assets, and therefore, without insurance, commerce grinds to a halt.

Insurance is an extraordinarily competitive industry. The industry is comprised of 1,000 companies. Some would say 3,000, but many are parts of parent companies; we ourselves have 65. We are the seventh largest in the property/casualty commercial business. Yet, we write only 2.5 percent of the industry volume. So, you can see this is a very fragmented industry. There are lots of competitors, and we have historically earned a low return on equity. The average return on equity for the insurance industry over the last 10 years has been around 8 percent, less than most other industries.

We are in the business of spreading risks. We play the law of large numbers. By that, I mean we charge everyone enough to cover the losses of the few. We are not, cannot, and will not be in the business of absorbing societal costs that we cannot spread. We in essence pass the costs on in terms of premiums to our insureds.

As you have heard from the other witnesses, this is a cyclical business. This last cycle, for perspective, was the worst in 50 years; therefore this recovery is the most damaging in 50 years. But it has to be seen in that light. This is not a normal cycle, and the reasons behind it have been well articulated.

Last, I have a private observation. I agree with Ralph Nader on one thing, although, I would state it differently. Insurance is probably not recognized as the best managed industry in America! On the other hand, having been in it for a while, I am far more sympathetic to the difficulties of managing an insurance company.

Now a couple of specific observations about Fireman's Fund: In 1985, we lost $44 million; 2 years ago when our losses began, we laid off 1,600 people. That was 12 percent of our workforce. Those were valued employees we just could not afford to keep. We have added $600 million to reserves, about 15 percent, in the last 2 years.

Today, almost no one who was in top management 2 years ago remains. Anyone who says this situation results from collusion among the good old boy network of insurance companies is dead wrong. The pain and the bleeding in these companies has been enormous. I am both sympathetic to what the industry has gone through, and I also recognize that there are some real problems.

Your mail and mine identifies them: Affordability and availability. These are separate issues, but they are interrelated. Why? We, the companies, lost money. We lost a lot of our surplus and therefore, lost capacity to write business.

Because our capacity was constrained, we had to back away from some areas of insurance that we previously had written. We concentrated on those lines of business that we thought we understood and where we thought we could make a profit. Some unpredictable, and heavy loss lines such as general liability were the first to be cut back.

For perspective, I think it is important to realize that this was a $118 billion industry in 1984. Most of the industry is still in good shape. Half the business is personal lines—auto and homeowner. There, the rate increases have been very moderate and in line with inflation, 6 or 7 percent a year. Lines like surety, ocean marine, inland marine, and property have been fairly orderly, albeit prices have had to increase.

The availability problem has occurred in general liability, which is between 5 and 6 percent of the total industry volume. That is where the current problem is. So this is a localized problem, where costs and availability are heavily impacted by huge claims and court settlements. The general liability problem includes pollution, drugs, medical malpractice, and product liability. In those lines, it is not clear that even if there was insurance that it would be affordable. The loss rates have become too high.

I would say that those are problems you must wrestle with in the years ahead. I would like to make three suggestions on how you can help.

One, let the market function. The market is well into the process of self-correction right now. I predict, at the risk of predicting, that by early next year, stabilization will reoccur in the industry, and it is impossible to think of any legislative action taking effect faster than that.

Two, I think we are going to need your help on tort reform, and here I have a recommendation: That you create a national commission on tort reform, composed of lawyers, insurers, businesses, consumers, academics, and jurists, with the idea of really discussing reform. The issues are very complex and I would, at this point, like to submit some of our thoughts into the record. [Submitted: "The American Tort System: A Time to Rebalance the Scales of Justice" and "A Citizen's Guide To Tort Reform."]

Three, at the end of the day, there may be some areas of insurance that are not affordable because they are too costly. In those very few areas, such as pollution cleanup and earthquake, some State and/or Federal action may be needed.

The CHAIRMAN. Thank you, sir. Mr. Martin.

Mr. MARTIN. I am Stephen Martin of the Hartford Insurance Group. I am here today representing the American Insurance Association.

The American Insurance Association members write the majority of the commercial lines insurance business written in the United States. Our industry, as I think you have been hearing, is subject to very highly competitive conditions. We have a marketplace of 300 to 400 companies writing commercial lines insurance, and each of them operates independently of the other in all respects.

I would like to comment very quickly about Senator Simon's concern about insurers conspiring, if you will, not to write business in a jurisdiction or with respect to a line of insurance. We are subject to the antitrust laws with respect to that kind of activity. We are because the McCarran-Ferguson Act specifically provides that we are subject to the antitrust laws with respect to any act of boycott, coercion, or intimidation, and we from our side have construed any agreement with regard to markets as an effort to boycott. We regard that as illegal behavior.

It does not exist. To the best of our knowledge, we have never had anyone assert with any support that it does exist. This highly competitive marketplace is very much affected by world insurance market conditions. We are, because we ourselves do not have the capacity to provide all the markets that are needed in the United States. We do not have the capacity to do it. We do not have surplus as to policyholders that will permit us to do that.

These world markets help to provide insurance in excess of the basic limits we are willing to provide. For example, if we provide $1 million in coverage, the excess market will be expected to pick up anything in excess of that to $5 million, and in some cases to $50 million or more. In addition, we require the world market to help us with reinsurance. Excess insurers require the world market to help them with reinsurance. Reinsurers expect the world market to help them with their retrocessions.

It is a capital-intensive business. Capital flows where a profit is anticipated, and this is what has happened to our industry in the period 1980 through 1985. More capital flowed, more capacity came in in a context in which the pie had not gotten bigger, but the capital scrambling for some of the pie did. And as a consequence, very intensive price competition ensued to the point where from day-to-day agents, our agents, and we are wholesalers with respect to commercial lines insurance, we deal through independent agents, our agents would tell us that they have a quote on a risk we wrote which is half that we were quoting and had been writing it for for some 5 years or so. So we lost business.

The only thing you can do in a marketplace like that, you either join them, or you hunker down and try to survive it. If you join them, you expose your solvency. I heard Mr. Beer suggest that there were some 50, I think it is really 60 companies in liquidation right now, 60 insurers. These more recent insolvencies will, I submit, with regard to a direct consequence of underpricing.

We have Ideal Mutual, Union Indemnity, Iowa National, companies that when they started out were doing the cashflow game in underwriting. They thought they knew what they were doing, and they got in very bad trouble. All of the actions undertaken by that kind of underwriting practice have to come home to roost at some point in time. You have got to pay for the long tail on the exposures you have written, and you have got to have the assets to do it.

Underpricing in claims on high investment yields resulted in increasing losses as investment income failed to keep pace with the losses. Negative operating results finally led to a tightening of the marketplace. So today we are seeing limited capacity, but please do not overstate what that means. It does not mean limited capacity with regard generally to standard commercial lines. Now there are exceptions.

Day care centers are an exception. Day care centers by and large throughout the country are experiencing difficulty in finding a market for insurance for a major reason. The reason is, the specialty carriers which wrote them either got into financial trouble or are close to insolvent, or lost their reinsurers.

There is a similar problem with regard to liquor liability. It is a similar problem but not the same with regard to municipalities. The Hartford is still writing municipalities. In any event, recognizing that there are these serious market availability problems even in the standard market, the American Insurance Association, the Alliance of American Insurers, and the National Association of Independent Insurers jointly are participating through their member companies in voluntary marketing programs in the States.

We have 34 marketing assistance programs dedicated to trying to find ways voluntarily to write those kinds of risks which are not finding markets. Those are underway. They are operational in a number of States. They will be operational in more. We are not seeing a great flow of business coming with regard to the MAP's, but they are there because we think they are needed.

There is an area with regard to unpredictability in terms of losses and future experience which is not being responded to today. Those areas have to do with the long tail lines where the long period between the time the policy is written and the time you can finally expect not to have any more claims under that policy is so long and so susceptible to changes within the tort system as to make it impossible to predict what your losses and expenses are going to be for that line. It is this kind of a situation which has created a problem for directors and officers for the host of professionals, medical malpractice for example. These are troubled lines.

The answers here, we submit, will be tort reform.

[The statement follows:]

STATEMENT OF THE AMERICAN INSURANCE ASSOCIATION

The American Insurance Association (AIA) is a trade association which represents 170 property and casualty insurance companies. The member companies of the Association provide the majority of the commercial liability insurance coverage written throughout the United States. We have been asked to present testimony associated with the scope of the availability and affordability of liability insurance problem currently being experienced by the purchasers of insurance.

Insurers are exhibiting neither panic nor irresponsibility by taking a conservative stance on writing certain lines of commercial liability coverage. Rather, they are being prudent in the face of unprecedented losses and a rapidly changing operating environment.

UNDERLYING CAUSES

The "insurance industry" is not monolithic. Even the largest companies have a small portion of the total market share in any single line of insurance. Individual insurers engaged in intense competition in the early 1980's in pursuit of the premium dollar in order to invest. Insurers were able to reduce the price of their product by balancing underwriting losses with investment income until 1984. Lower prices inure to the benefit of the policyholder.

Extraordinary losses experienced by insurers, particularly in commercial casualty lines, have forced insurers to raise premiums dramatically. These premium increases have clashed with the expectations of policyholders, causing hardship among some policyholder groups who rely on various lines of commercial liability coverage.

Many insurers have experienced such financial hardship that they have withdrawn from writing some of the lines of insurance they formerly wrote. This is clearly the case insofar as specialty lines, such as day care centers, dram shop liquor liability, and, to some extent, municipalities are concerned. However, withdrawal from these lines of insurance is, in many instances, also generated by the reinsurance market, which itself has sustained massive financial losses from its U.S. operations.

Insurers and reinsurers are recognizing that pricing and underwriting expectations for many classes of commercial liability insurance have been rendered unreliable because of the unpredictability of future losses. Judicial misinterpretations of insurance contracts, statutory and common law modifications of the tort system, mandated minimum levels of insurance in federal [1] and state laws, society's increasing expectation of recovering higher and higher amounts from some "deep pocket" for virtually every injury, have taken their toll on the predictability of losses.[2] These developments affect virtually all forms of commercial liability insurance, but they especially affect long-tail exposure where the insurer's (and reinsurers') policies can be invoked five, ten, or even twenty years after the policy was written.

The most basic concept underlying insurability and insurance contracts is the concept of risk. "Risk" means literally the "chance of loss" or the "probability of loss." If a loss is certain to happen, then there is no risk of loss to transfer, and an insurance transaction cannot take place. There is a growing perception among underwriters that the accumulation of legal remedies provided under state and federal liability systems are changing a hitherto insurable probability of loss to an uninsurable, virtual certainty. Underwriters are attracted to predictability of loss but must avoid inevitability of loss.

The second basic fundamental of underwriting and insurability is that of predictability. If there is no way to forecast the timing or amount of a loss from past experience, then the loss is unpredictable. Any estimate would be pure speculation.

Standard coverage for liability insurance originally applied to bodily injury or property damage "caused by accident". The accident concept was also the time trigger of coverage and the building block of limits of liability. An individual policy covered only accidents which occurred during the policy period.

The classical accident, as perceived by insurance underwriters and policy drafters, was concrete, rather than abstract. They regarded an "accident" as a sudden event of a physical nature that happened by chance at a definite time and place and caused rather obvious injury or damage—a collision of vehicles, a scaffold which broke, a roof which collapsed. "Accident" was not a legalistic concept. The underwriters' conception of "accident" harmonized well with both the classical liability principles of tort law and the fundamentals of insurability. Certainty as to time and place laid the foundation for reasonable predictability.

By 1970, it became apparent that coverage based solely on the classical accident concept was no longer adequate for most insureds. There were true "risks of loss" that did not arise out of sudden causes, but were the result of continuous or repeated exposure to physical causes which resulted in nontraumatic, multiple causation, long-latency diseases.

The extent of exposure for liability insurance coverages has changed dramatically in the past decade. The relationship between low level exposures to useful, but sometimes harmful substances, and injuries to human beings is not well understood today and is still to a large extent speculative. Tort law a few years ago did not concern itself with speculative possibilities of harm. Doctrines of joint and several enterprise liability had not been formulated. It was not until 1974 that the deluge of asbestos-related claims began.

The concept of accident as a single scenario involving one person causing another's harm has changed. Increasingly, recent tort law has applied traditional concepts of individual risk-placing causation and harm into the modern commercial context. The result is that certain communities, types of persons throughout the nation, or classes exposed to risk of harm through commercial enterprises have sought to redress their harm through the liability system and have sought to hold entire industries liable for the creation of public risks. New types of suits differ from traditional cases in that:

Injuries are medically complex and have multiple causes, often resulting in the introduction of presumptions into the legal system,

Injuries have been attributed to exposure over a lengthy period of time,

Injuries have been applied to groups or classes of claimants,

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[1] Bus Regulatory Reform Act, Motor Carrier Act, Superfund, and the Resource Conservation and Recovery Act.

[2] *Ayers* v. *Jackson Township* (N.J., 1983)—$15.6 million settlement for alleged waste site injuries.

Dietz v. *Gray Brothers* (Pa., 1984)—$750,000 judgment for alleged waste site injuries.

In Re Agent Orange (N.Y., 1984)—$180 million settlement for alleged defoliant injuries.

U.S. v. *Olin* (Ala., 1983)—$24 million settlement for alleged DDT disposal site injuries.

Piatt v. *Independent Petrochemical* (Mo., 1983)—$2.6 million judgment for alleged dioxin injuries.

LaPoint v. *Hooker Chemical* (N.Y., 1984)—$20 million settlement for alleged Love Canal waste site injuries.

Defendants are often a small number of entities or businesses or whole industries involved in certain types of behavior.

The Deep Pockets Report, prepared by the Institute of Civil Justice in 1985, indicates awards differ among types of defendants. Awards against corporate defendants averaged over $120,000 as against awards for individual defendants of $18,500. Where injuries were the same, corporate defendants paid 30 percent more than individual defendants. Notably, governmental defendants, which 20 years ago were protected by the Doctrine of Sovereign Immunity, were subjected to an average award of $38,000.

Certain classes of additional defendants are perceived differently than in the past. The problem of drunk drivers causing an innocent third party's injury has resulted in the expansion of liability to include the provider of the alcohol. In the past, everyone understood that some risk was inherent in any vaccine. However, in recent times, law suits have proliferated against vaccine manufacturers.

Recent court decisions have created new and unpredictable liabilities for property/casualty insurers. As stated in the "Villanova Law Review:"

In two recent toxic tort cases, the highest courts of California and New York have held that liability for injuries allegedly caused by DES can be imposed upon defendant-manufacturers without proof that those defendants made DES which caused the plaintiffs' injury. In *Sindell* v. *Abbott Laboratories* (1980), the California Supreme Court accomplished this result by fashioning a "market share" theory of liability. Under this theory each defendant was liable for the proportion of the judgment represented by its share of the DES market unless the defendant could demonstrate that it could not have made the product which injured the plaintiff.

Subsequently, in *Bichler* v. *Eli Lilly & Co.* (1982), the New York Court of Appeals affirmed a jury verdict against a manufacturer of DES which was based upon the plaintiff's theory that Lilly, in concert with other DES manufacturers, had wrongfully marketed this drug without proper testing. Under this "concert of action" theory, the court in Bichler found the defendant liable for the plaintiff's injuries even though the plaintiff had failed to prove that Lilly—the only defendant named in the suit—was the manufacturer of the DES that the plaintiff's mother had ingested.[3]

In both *Sindell* and *Bichler*, the rationale underlying the courts' decisions was the same. In both cases, the court was confronted with an innocent victim unable to prove which manufacturer harmed her because of the long latency of the injury coupled with the similarity among the products of the different manufacturers. Faced with a choice between not compensating the victim and holding liable a company which may not have caused the harm, each court chose a theory which would permit compensation of the victim.

Other judicial decisions have weakened defenses based upon the state of the art and technological or economic feasibility. In *Beshada* v. *Johns-Mansville Products Corp.* (1982), a manufacturer of asbestos in the 1930's was found to have an obligation to warn of the dangers associated with asbestos products. The manufacturer was not permitted to prove that at the time in question it was not possible to determine the possible harmful affects of asbestos. Prior to this decision, under the state of the art defense, even in strict liability cases, no manufacturer would be held liable for harm caused by conduct or products that could not have been anticipated under state of the art knowledge. This novel decision is a particularly significant finding for chemical product manufacturers because they may be held liable even in instances in which the harmful potential of the product was not discoverable at the time.

Rulings of this type dispense with a fundamental element of the tort system—proof that the defendant was responsible for the plaintiff's harm. Such rulings disrupt the reasonable expectations of both manufacturers and insurers concerning the limits of their liability.

Judicial misinterpretations of insurance policies designed to respond to limited types of pollution exposures have created additional concerns among insurers. Recent court decisions have expanded insurance coverage for cleanup of waste treatment, storage and disposal facilities beyond that which the liability policies were designed to provide. Insurers have lost confidence in the words and phrases of art which have been placed in pollution insurance contracts in order to exclude coverages which may be provided in other insurance policies or which may be properly excluded due to the unpredictable or potentially catastrophic nature of the exposures.

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[3] "Villanova Law Review," Volume 28, No. 6, September, 1983, p. 1102-1104.

The Comprehensive General Liability (CGL) insurance policy is the instrument used to provide the vast majority of insurance protection for commercial entities from liability for bodily injury and property damage. The CGL insurance policy is a contract between the insurer and the insured in which the parties define both the risks covered by the insurance and those excluded from coverages. The premium charged by the insurance company relates directly to the frequency and severity of the risk that the company intends to insure. Courts have elected to misinterpret the insurance policy contract language in order to maximize insurance coverage for damages related to hazardous waste.

Some decisions have gone so far as to rewrite policy terms and create coverage which insurers never intended to provide and for which no premium was ever collected. Specifically, we perceive a trend in court decisions that interpret our standard CGL policy to broaden the scope of intended coverage as follows:

Narrowing the intent of the owned property exclusion to find liability for damage to an insured's property.[4]

Overriding the scope of the pollution exclusion so that, for example, well contamination caused by seepage at a hazardous waste site that occurred over a 12 year period was found to be covered despite the policy requirement that coverage be afforded for only "sudden and accidental" pollution.[5]

Converting the CGL's policy dollar limit per occurrence into a per claim dollar limit.[6]

Setting aside the definitions of property damage and bodily injury so as to award speculative damages for the possibility of future harm.[7]

The possibility of similar misinterpretations leading to expansion of coverage in the commercial auto policy exists due to the inclusion of the category of damages for "environmental restoration" in the Motor Carrier Act. Many commercial auto insurers have reacted by excluding environmental restoration from their commercial auto policies.

Concurrent with judicial misinterpretations of insurance contracts, rapidly expanding liability concepts, and the recent drain on insurance industry surplus, the Congress has created a series of expanded responsibilities for insurers and their policyholders by mandating evidence of financial responsibility in a series of recently enacted federal legislation. The Motor Carrier Act (1980) and the Bus Regulatory Reform Act (1982) have mandated large minimum insurance requirements for buses and trucks. In the case of a motor carrier transporting extra-hazardous substances or a bus with a seating capacity in excess of fifteen, the minimum requirement for insurance is $5 million per vehicle. Although the Resource Conservation Recovery Act was enacted in 1976, the final rule associated with the financial responsibility requirements for waste, treatment and storage facilities was promulgated in 1980. Those financial responsibility requirements have been phased-in over the last 5 years. An additional wave of financial responsibility requirements can be anticipated in association with the Comprehensive Environmental Response, Compensation, and Liability Act of 1980. All of these requirements for evidence of financial responsibility have coincided with the insurance industry's underwriting losses beginning in 1979.

INSURER OPERATING RESULTS

In order to put the present liability insurance problems in perspective, it is necessary to understand the overall financial condition of the insurance industry today. Since 1980, losses and expenses have exceeded premiums primarily because prices failed to keep pace with loss costs. As a result, an unbroken string of underwriting losses began in 1979 and grew at an average annual rate of $3 billion through 1983. An even more dramatic increase took place in 1984 when underwriting losses jumped $8 billion, reaching $21.3 billion. Losses from underwriting for the six years 1979 through 1984 totalled $55 billion. With investment income falling far behind underwriting losses, the industry's pre-tax operating income—the combination of investment income and underwriting results—plunged to a negative $3.8 billion in 1984. Operating losses for the first nine months of 1985 have exceeded $3.5 billion.

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[4] *See* for example, *Riehl* v. *Travelers Insurance Co.*, F. Suppl., Civil Action No. 83-0085 (W.D. Pa., August 13, 1984).

[5] *See*, for example, *Jackson Township Municipal Utilities Authority* v. *Hartford Accident and Indemnity Company*, 186 N.J. Super. 156, 451 A.2D 990 (1982). *Waste Management of Carolinas, Inc.* v. *Peerless Insurance Company*, 323 S.E. 2D 726 (Court of Appeals of North Carolina, December 28, 1984).

[6] *See Township of Jackson* v. *American Home et. al.*, Docket No. L-29236-8 (Law Div., August 31, 1984).

[7] *Ayers et. al.* v. *Township of Jackson*, 189 N.J. Super. 561 (Ocean County, April 5, 1983).

The commercial liability lines experience has been particularly negative. Four key commercial lines—general liability, commercial multi-peril, workers' compensation and commercial automobile—have suffered enormous underwriting losses. General liability leads all lines of insurance with the highest combined ratio of 152.

As a business, the industry cannot afford to indefinitely price its product at less than cost. As stated by the Insurance Service Office.[8]

The decline in surplus and questions as to adequate loss reserves have raised concerns about the solvency of many insurers. In 1984, at least 22 property/casualty insurance companies were found to be financially impaired. Most of these companies were insolvent. Additionally, several sizable insurers were placed in rehabilitation by regulators with an indication given that liquidation could not be avoided. In total for 1984, companies accounting for more than one fifth of industry premiums failed 4 or more IRIS tests. As of mid-November 1985, 38 companies have become insolvent since the beginning of 1984. That is more insolvencies than in any full two-year period since guaranty funds were formed, and the books aren't yet closed for 1985.

A.M. Best Company annually conducts a specialized financial analysis of most United States insurance companies and expresses its evaluation in the form of a rating. All companies rated "Excellent" are considered to be outstanding and have no material unfavorable variances from A.M. Best's averages. Lower ratings reflect increasingly unfavorable variances from A.M. Best's industry standards. An "Excellent" rating is considered essential if an insurer wishes to do business with top U.S. corporations, municipalities and government contractors.

From 1982 to 1983, 30 companies' ratings were upgraded to "Excellent" while 78 companies' ratings were downgraded from "Excellent". In 1984, there were 38 increases to "Excellent", but 150 companies received rating decreases from this level. When the 1985 ratings were issued, 25 companies had an increase in their rating while 331 companies saw their rating drop.

The declining solidity of the property/casualty industry is also illustrated by what is termed the exposure ratio, defined as the ratio of net written premiums to surplus. The percent of industry premiums written by companies with high exposure ratios has increased dramatically. The National Association of Insurance Commissioners (NAIC) has selected a premium-to-surplus ratio of 3-to-1 as a maximum. Any insurer writing above this level fails the premium-to-surplus test. While only 4 percent of the industry's premium was written by companies with a premium-to-surplus ratio above 3-to-1 in 1982, by 1984 that increased to 15 percent and estimates are that it will exceed 20 percent by the end of 1985.

While the financial results of the property and casualty insurance industry are partly the result of a competitive pricing cycle, the industry has also come to recognize that it has become a victim of fundamental changes in the civil justice system during the past decade. More and more, insurers have encountered court interpretations of prior insurance contracts which expand coverage beyond that which insurers intended. As a result, the availability and cost of insurance for current liability is significantly influenced by: insurers' concern about potential unanticipated past liability; the magnitude of potential liability, both past and future; the seeming inability to use contract language to prudently limit insurers' exposure; and a civil justice system that continues to create new theories of liability and to expand older theories.

VOLUNTARY SOLUTIONS

The American Insurance Association has thus far categorized pollution liability and asbestos abatement contractors' liability as falling into the unmanageable or uninsurable category. In addition, there are a number of availability problems in lines that are badly damaged by the liability system, but there is still a potential that insurers can provide coverage.[9] In these areas AIA will work actively with its companies, other trade associations and state insurance commissioners to explore voluntary Market Assistance Programs or other market solutions to the problem. A Market Assistance Program (MAP) establishes a central administrative point where a buyer who is experiencing difficulty in purchasing insurance may come in order to be referred to one or more participating insurers who employ their established underwriting criteria and rating plans. A MAP can also serve to gather information about real or perceived availability problems and be a focal point around which the insurance department, buyers' groups, agents and brokers may discuss availability problems in a constructive manner.

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[8] "Financial Condition of the Insurance Industry—An Update."

[9] Day Care Centers, Liquor Liability, Directors and Officers, Physicians Malpractice Insurance, Nurse Midwives, Commercial Auto Insurance (Long Haul Trucking Companies and Bus Companies), Rural Homeowners Insurance.

It should be emphasized that merely shifting the burden from one insurance mechanism to another does not address the key problem associated with availability/affordability of liability insurance. Artificial, involuntary insurance mechanisms such as Joint Underwriting Associations mask the underlying problem. The answer to this dilemma has been and remains tort reform. There is a tendency among some regulators and legislators to adopt the expeditious approach of forcing insurers to write insurance coverage, either on an assigned risk or a pooled basis. This solves the immediate availability problem at no apparent cost to the public treasury and with no need to address the difficult task of reforming the tort liability system.

Structuring alternative insurance mechanisms addresses a symptom rather than the cause of the current commercial casualty insurance availability and affordability situation. Although alternative insurance mechanisms may be necessary in order to respond to federal and state financial responsibility requirements, a thorough review of common law decisions and state and federal statutory liability concepts is essential if commercial casualty insurance is to be both affordable and available in the future.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. Beginning in 1979, the insurance industry began to experience underwriting losses in its property/casualty business. Those losses continued to grow over the next several years, although at a steadily declining rate. In 1984, however, there was a dramatic increase in underwriting losses.

What happened in 1984 to cause such a drastic increase in property/casualty underwriting losses?

Answer. The very substantial increase in underwriting losses in 1984 over underwriting losses in 1983 is attributed, we believe, to the accumulative effect of underpricing in prior years, coupled with a surge in 1984 losses. It is especially noteworthy that, for the 1980-1983 period, industry accident year claim costs growth is estimated at near 10% while average premium growth was just above 4%. This more than 5% deficit was compounded annually. It should not be overlooked that claim costs have continued to grow at a constant 9-10% rate notwithstanding that the growth in prices throughout the economy has declined from 14% to 4% in the 1980-1984 period. Claim costs for general liability insurance have continued to grow at an accelerating rate. This suggests to us that the liability system is generating increased frequency and severity of claims.

From a statistical perspective, here is what happened in 1984:

(a) Claim costs continued to grow at a 10% rate, fully 6% more than 4% consumer price growth;

(b) there was an economic recovery, but claim costs increased by 2%, and;

(c) the trend of a −2% acceleration in the weakening of reserves was reversed with a 4-point swing to a +2% acceleration in reserve strengthening.

Incidentally, it does not appear to be accurate to suggest, as does the question, that losses continued to grow at a steadily declining rate.

Question. What commercial liability lines, if any, is your company steering away from and why? Could you provide statistical data on the losses you have incurred in those distressed lines over the past three of four years?

Answer. The Hartford over the years has positioned itself as a market largely for standard commercial business. It is difficult to generalize or to be too specific about our underwriting orientation without being prolix other than to note that we are not a market for pollution liability insurance and while we do write some, we generally are not a market for long-term latency exposures. We have provided specialty markets for many non-standard exposures through a separate surplus lines and excess insurance operation, but much of this business was dependent on the availability of facultative reinsurance. As the facultative market disappeared, we have withdrawn from many of these markets. We have not been a market for day-care centers, although we do write a few. We have not been a market for liquor liability. Although we do write some, we are now limiting ourselves to risks with minimal and well-controlled liquor exposures. We have not been a market for nurse-midwives. We continue to provide a market for municipalities in many jurisdictions.

Although we do review our own data by class of risk where it is sufficiently credible, we generally utilize industry-wide data developed by the Insurance Services Office. It is important to note that although historical data is helpful as an underwriting tool, the underwriting function relies heavily on experienced judgment in assessing and pricing risks. Underwriters have to try to predict the riskiness of the exposure, the potential for and possible extent of losses, and the potential for future changes in tort doctrines, the cost of claims, and the reliability where challenged in court of essential policy language.

Question. To what extent have developments in the civil justice system influenced your decisions regarding distressed lines of insurance?

Could you provide for the record the portion of claims paid as the result of court awards or threatened lawsuits, and the portion of claims paid through uncontested settlements, in those particular lines?

Answer. Court decisions, such as in the *Jackson Township* case, do affect our underwriting judgments. Prior to this and similar decisions, we were willing to provide limited pollution coverage, coverage against sudden and accidental discharges. We did not intend under the policies involved to provide coverage for gradual pollution claims. The *Jackson Township* decisions convinced us of the need to utilize an absolute pollution exclusion.

Court decisions imposing liability on municipalities for police abuse have induced us to utilize police abuse exclusions, and decisions affecting the liability of day-care centers for child abuse have led to our excluding coverage for that exposure.

Although we do not maintain claim statistics with regard to the specific matters requested, we expect from claims office reviews and earlier closed-claims studies that about 90–92% of claims are settled before suit is filed, and that only 3% of lawsuits (about .005% of claims) are tried to verdict.

Question. To what extent is your willingness to insure certain lines of insurance dependent upon the availability of reinsurance, and to what extent do your reinsurers advise you on the premiums you should charge for a particular line of insurance?

Answer. On an overall basis, the availability of reinsurance does affect our capacity. The unavailability of reinsurance would affect our underwriting judgments. For example, we might find it appropriate to increase our primary retention level and to exercise tighter management control over the kinds of business we would be willing to write. However, the whole of the property/casualty insurance market is quite diverse and reinsurance needs vary significantly by types of business.

For standard commercial lines, we have not had a reinsurance availability problem and reinsurance has not been a major factor in making underwriting decisions. Normally, The Hartford assumes the major portion of the risk and the function of reinsurance is to protect us from catastrophic losses.

However, where the loss potential is relatively unknown or unpredictable, for example, where new insurance products or specialty lines are involved, we do need to be able to obtain reinsurance above a low level of primary insurance. With regard to these kinds of exposures, if reinsurance in excess of our retention were not available, we would have to determine whether and to what extent we should make our own limited capacity available to provide the higher limits of coverage.

Reinsurers do not advise The Hartford with respect to the premiums we charge for any line of insurance.

Question. What steps can or should the insurance industry take to smooth out the historical cycles that appear to cause such dislocation in the economy?

Answer. This last cycle was driven by over-capacity, which produced excessive price-competition, and is resulting in very costly insurer insolvencies. Insurance regulators are concerned with the need to moderate the cycles without impairing reasonable competition or the willingness to provide markets. They are looking at imposing reasonable limitations on swings in individual risk pricing. The following recommendations of the Connecticut Governor's Task Force on Insurance Availability and Affordability are illustrative of one method to achieve this.

The Committee is of the opinion that in many instances the companies utilizing individual risk rating plans, have granted excessive modifications to rates filed with the Insurance Department. In order to more adequately monitor and assess the impact of deviations or modifications and thereby control the stability necessary in the market, the Committee recommends the following: that the Commissioner promulgate regulations which define acceptable criteria insurers will use in their individual risk rating plans and establish an acceptable range of modifications and deviations to filed rates that can be applied in the determination of premiums for individual policyholders.

It is further recommended that the Commissioner require insurers writing Commercial Multi-Peril, General Liability and Commercial Auto Insurance to produce data in a format and on a time schedule as the Commissioner shall direct, showing the relationship of the aggregate premiums actually charged policyholders for each line of insurance to the premiums produced by their filed unmodified rates. Any company whose date indicates the aggregate premiums actually charged policyholders for a line of insurance exceed the premiums produced by their filed unmodified rates by more than a percentage amount established by the Commissioner, or fall below the premium produced by their filed unmodified rates by more than a percentage amount established by the Commissioner, shall be required to justify the continued use of its rating plan, its filed rates, or both.

Question. Are tort reforms going to result in premium decreases?

Answer. Meaningful tort reform will moderate the already accelerating growth of commercial liability insurance loss costs. Tort reform will also make insurance more available for difficult to write business. It could regenerate a willingness by physicians and surgeons to provide professional services, by pharmaceutical houses to produce needed vaccines and other ethical products and by municipalities and others to provide recreational activities.

Significant reforms which are likely to be enduring will quickly be reflected in insurers' pricing as their confidence in predictability of losses returns and the dynamics of vigorous competition in the marketplace recur.

Question. Why is it that states with vastly different tort laws are paying the same insurance premiums and suffering equally from skyrocketing insurance costs? What good does it do for a single state to enact tort reform if the insurance companies do not respond with state-by-state pricing policies?

Answer. Products liability insurance rates are made on a countrywide basis. For commercial liability insurance, other than products, insurance rating plans do reflect the experience of the individual states. With regard to products liability, when states during the late 1970's began to enact products liability tort reform on a state-by-state basis, The Hartford implemented Products Liability Tort Reform Modifiers in its rating plan. The modifiers were credits to be used in pricing which reflected our judgments on the value of the particular reforms which were enacted. They were effected in about fifteen states, and the states which enacted tort reform benefited from them. The modifiers were applicable based on an assessment of the extent to which the insured's exposure was intra-state vis a vis inter-state. The modifiers were fully applicable where the exposure was intra-state, and less applicable where the exposure was inter-state.

Although such modifiers would not be appropriate where general tort reform will affect different kinds of exposures differently and much more unpredictably, we would expect to reflect the value of tort reforms in our underwriting and pricing judgments on an individual state basis. For example, if state A eliminated the joint and several liability doctrine, we would expect that more companies would be willing to write municipalities, and that they would reflect the assumed value of the change in the law in their pricing. This process would be generated by competition for business which has become more desirable. Thus, it is that individual state tort reform would be reflected in pricing for that state.

Question. An AIA response to a question for the record from the December 3rd Business, Trade & Tourism Subcommittee indicated that a number of insurance industry studies are currently collecting data on the role of actual or potential litigation in the settlement of product liability, auto, and homeowners cases.

What is the nature of those studies? Are there similar studies being conducted in the various commerical liability lines, other than product liability? If so, could you describe those efforts?

Answer. We have limited knowledge of the specific studies referred to, but we understand that various studies are underway which may be relevant to your interest. For information about them, bearing in mind that they are not yet completed, we invite you to contact Marvin Shulman, Vice President, Research and Development, American Insurance Association, 85 John Street, New York, New York, 10038, and Donald Segraves, Executive Director, All-Industry Research and Actuarial Committee, 1200 Harger Road, Suite 222, Oak Brook, Illinois, 60521.

Question. Do you feel a closed-claims study of the several distressed lines of commerical liability insurance would demonstrate the relationship between the tort laws complained of by the insurance industry, and the current price and scarcity of insurance?

Do you know of any other way to develop this information?

Answer. Insurance availability problems appear to be relatively limited. That is, the 85–90% of commercial lines premiums which comprise the standard commercial lines market are not facing an availability crisis. Pricing in this market is generally only returning to the levels in effect way back in 1980, following an interim period of prices driven way downward by intensive competition in the marketplace. The so-called distressed lines appear to be limited, for the most part, to business written by specialty carriers. That business was characterized by high penetration (the specialty carrier wrote a lot of it), and many of those carriers abandoned those markets because they became insolvent, suffered severe operating losses, or lost the reinsurance upon which they depended heavily.

It is not clear to us that a closed-claims study of day care, liquor liability, municipal liability insurance, and so forth would demonstrate the relationship suggested by the question. Each of these lines reflects in its pricing needs and availability problems particular insurers' concerns with the insurance exposure involved somewhat on a state-by-state basis. It should be noted that in some instances the gaps in availability for day care centers and liquor liability are beginning to be filled by new entrants into these markets or by the return of former writers. As to municipal liability insurance, some insurers, such as The Hartford, are continuing to provide a substantial market.

The real problem for commercial liability insurance buyers will continue to be the increasing cost of coverage. Those costs are a reflection of underlying changes which continue to occur throughout the tort system. That cause and effect relationship is most clearly borne out by the explosive pricing which has occurred over the past ten to fifteen years for medical malpractice insurance. Two closed-claims studies for this line when its troubles were first observed in the mid-1970's were then completed, but they led to relatively little in the way of tort reform. In fact, it is not at all clear that those closed-claims studies themselves (which were countrywide in scope) generated reforms. But reform did occur in some states. In California, a very significant package of reforms was enacted in the mid-70's. Ten years later, their effects are reflected in comparative cost studies of that state's tort system compared to the cost of medical malpractice insurance in other states. The limited data available to us clearly suggests that those reforms were very effective in reducing or stabilizing those costs in that state. Reform occurred not just because a closed-claim study was undertaken, but because the medical societies understood that their insurance costs were being driven upward by the changes which were occurring in the tort system.

So it is with the business and industry movements seeking specific tort reforms in many of the states. Those reforms have been identified as most likely to have a stabilizing effect on the cost of the tort system and liability insurance costs. Some of those reforms are similar to those enacted ten years ago in California for medical malpractice which do support their stabilizing effect. Clearly, those reforms will help make insurance exposures more predictable and should alleviate the availability problems for the distressed lines they are most likely to affect. A closed-claims study may help in identifying useful reforms, but surely useful and fair reforms can be identified without a closed-claims study.

The CHAIRMAN. Gentlemen, I am sorry to say there is a vote now on the Senate floor, and I think we will break for the vote and be back in about 5 minutes or so, if you could stand by.

Mr. Berman, what is your situation with respect to your flight? Would you like to be excused now?

Mr. BERMAN. I think I would like to be excused.

The CHAIRMAN. All right. Thank you, sir. Thank you for your testimony.

Mr. BERMAN. We will be happy to answer any questions you may have by mail.

The CHAIRMAN. OK, we might submit some for the record.

This panel can stay around, I hope, all of you? I want to say, in case I forget it later, we do have some questions that we do want to submit to this panel, and maybe other panels for the record, so I hope you would be willing to answer some in written form. But stay put. We will be back in about 5 minutes.

[Recess.]

The CHAIRMAN. Mr. Mitchell, you are next.

Mr. MITCHELL. Mr. Chairman, my name is Bradford Mitchell and I am president and chief executive officer of Harleysville Mutual Insurance Co. in Harleysville, PA. Harleysville Insurance is a mutual property/casualty insurance company licensed to do business in 23 States. We write most all property casualty insurance lines, and in 1985 our premium volume was $360 million split about 50/50 between commercial lines and personal lines.

Harleysville is also a member of the National Association of Independent Insurers, a voluntary national trade association of nearly 500 property/casualty insurers, and it was my pleasure last year in 1985 to serve as chairman of that organization.

Mr. Chairman, the committee has a copy of my prepared remarks, and I would like to have them presented in the record.

The CHAIRMAN. You did not even have to ask. It is automatically done.

Mr. MITCHELL. I would like to go away from those remarks now.

The CHAIRMAN. Good.

Mr. MITCHELL. Having sat here this morning listening to many of the questions and many of the statements made, especially in the area of tort reform, Senator Pressler's question with respect to specifics, how can this be done, nobody ever seems to come up with something in the way of specifics, I would like to relate a case that we concluded last year which, I think, demonstrates quite markedly the necessity to do something in the area of tort reform in specific areas.

The case arose in New Jersey. The facts are essentially these: Two motorcycles were proceeding down a street. One was a normal motorcycle, the other a chop bike. They were proceeding side by side. A chop bike is one that has been modified to put a small wheel on the front, extend the handlebars up, and other modifications. In that type of a modification, one must reduce the braking ratio because of the small front wheel. It will burn it out. The actual reduction in braking capacity of this bike was 35 percent.

They are proceeding down the street. A car enters from the right with the intention of going directly across the street in front of these two motorcycles. The normal bike was capable of stopping, and did stop. The chop bike had a passenger on the buddy seat behind the driver. The passenger was wearing a large belt with a big metal buckle, part of which protruded in front of him.

The testimony of the driver at the trial was that he tried to brake, realized he could not brake, and so he laid the bike on its side and slid into the vehicle wheels first. The driver's spine was severed, and he became a quadriplegic. He is a quadriplegic.

Up until this point, I have not indicated who our insured was. In fact, it has not come into the factual situation. The car that entered from the right had minimum liability coverage, $25,000. Bear in mind, we have a quadriplegic. It was obviously necessary in the plaintiff's attorney's thought to find a deeper pocket in which to get the compensation necessary.

Our insured is a small business in New Jersey which manufacturers and installs seat cushions. It had installed a seat cushion on the buddy seat of the motorcycle. It was alleged by the plaintiff that in installing the buddy seat he had tightened it too tight, and therefore made the material slippery, and as a result of being slippery the passenger on the buddy seat slid forward in the accident, the buckle and the protruding part severed the driver's spine, and he became a quadriplegic.

We took this case to trial, feeling that our insured, if negligent, was a very minor part compared to all of the other things we have said. The resulting verdict of the jury was $2.5 million plus $900,000 interest for a total of $3.4 million for the quadriplegic.

I am not denying that the quadriplegic may have deserved $3.4 million. What I am saying is the part contributed by our insured in installing the seat cover on a buddy seat on a chop bike with a passenger with a protruding metal belt buckle is infinitesimal.

The insurer of the vehicle that entered from the right threw his $25,000 in in the very beginning. Obviously, he had no defense at all. It was clear liability on the part of the car entering from the right.

It left our insured or our company to come up with the remainder of the $3.4 million, because of joint and several liability. It would seem to me that that is an area that should have some attention, to proportion the amount of the negligence to the amount that he has to pay.

My time is up. Thank you.

[The statement follows:]

STATEMENT OF BRADFORD W. MITCHELL, PRESIDENT AND CHIEF EXECUTIVE OFFICER, HARLEYSVILLE MUTUAL INSURANCE CO.

My name is Bradford W. Mitchell and I am President and Chief Executive Officer of Harleysville Mutual Insurance Company in Harleysville, Pa.

Harleysville Insurance is a mutual property/casualty insurance company licensed to do business in 23 states. We write all property/casualty insurance lines except medical malpractice insurance. In 1985 we had a premium volume of 360 million dollars which ranked us 60th of the top 100 property/casualty insurers in the United States.

Harleysville also is a member of the National Association of Independent Insurers, a voluntary national trade association of nearly 500 property and casualty insurers. It was my pleasure to serve as Chairman of NAII in 1985.

NAII provides a truly representative cross section of the property and casualty insurance business in America, and ranges in size from the smallest one-state companies to very large national underwriters, consisting of both stock and non-stock companies.

We very must appreciate this opportunity to testify on what is termed the liability insurance problem for commercial business.

During the past year, the property/casualty insurance business has come to the forefront as a major public issue. I know that every member of this committee, indeed, every Member of Congress, is hearing on a daily basis the complaints from businessmen, municipalities, daycare operators, nurses, architects and engineers, doctors and midwives—almost anyone who has to buy liability insurance, including those of us in the insurance business who have to buy officers and directors insurance—over the cost and availability of insurance. I am hearing the same complaints from the same people.

Last year, in 1985, the property/casualty insurance industry net operating loss was $5.5 billion. When we consider realized capital gains from the sale of stocks and assets to offset the loss and tax credits, we had a net after tax income of $1.7 percent, less than a 2 percent return on our total net worth.

The usual explanations for the industry's illness include inflation, the recessions of the mid-70's and early 80's, and the bane of cash-flow underwriting.

But none of these is completely convincing. Insurers have weathered inflation and recessions for decades without getting beat up to this extent. And while it is true that some companies, in the commercial lines, nearly perfected Kamikaze pricing, cash-flow underwriting has been part of company operations since the 50's, when the shift from property to long-tail liability coverages amassed large amounts of cash in dormant reserves that could be used for investments.

The industry has had five underwriting cycles since since the 50's. They have gotten shorter on the upside, longer and deeper on the downside. The first three bottomed out at a combined ratio of 103, the fourth at 108, and the latest one at 118—a dramatic jump.

The financial problems of the industry have been caused both by downward pressure on prices in the past due to a fiercely competitive marketplace, contrary to our critics who claim there is no competition in the insurance industry, and fundamental changes in tort liability. This latter situation is not amenable to the normal corrective dynamics of the underwriting cycle since the root causes are not internal to the industry.

Finally, this situation will affect various markets unevenly, with the more serious dysfunctions occurring in those classes or coverages most impacted by external legal trends. Even in short-tail lines like auto insurance, five years is not unusual for the length of time for a case, especially in urban areas.

Million-dollar verdicts awarded in the United States skyrocketed to 251 in 1982 from one in 1962 and to 360 in 1983, the latest year for which figures are available. The lure of jumbo awards in civil suits often contributes to increased litigation.

Civil suits filed in state courts rose 22 percent from 1977 to 1981 and appeals climbed 32 percent. Civil case filings in federal district courts soared to 206,000 in 1982 from a mere 35,000 in 1940. Last year there was one private civil lawsuit filed for every 15 Americans.

We have all heard about the million dollar judgments, and I won't bore you with more horror stories.

Yet, it's not the case that goes to trial and results in a multi-million dollar verdict that should overly concern us. It's the thousands of routine cases that are settled, because the courts' inconsistencies, and their eagerness to find ways to help the claimant hit the jackpot, that have destroyed insurers' faith in the legal process. Who can trust the courts when they change the rules in the middle of the game or rewrite contracts from the bench? What it all adds up to is not only more and larger claim payments, but higher administrative costs as well, because of the added uncertainty and expense now associated with going to trial.

Deplorable conditions like these can be papered over with rate increases and more selective underwriting, but they will not be corrected until the tort system is reformed. We are in the same boat as our insureds—we are all victims of a runaway tort system, but we are the first victims in line. It's only a matter of time before the rest of society joins the infinite list of victims.

At a hearing back in September before the Commerce, Transportation and Tourism Subcommittee of the House Energy and Commerce Committee, NAII Vice President and General Counsel John B. Crosby summed up the short term prospects very well when he said, "In order to continue to provide the insurance protection necessary for a growing economy, the companies must return to a position of solvency and this can only be accomplished through price increases. In the short run this will be traumatic on the budgets of buyers, public and private.

To do otherwise raises the prospect of driving a large segment of the industry into insolvency and forcing many buyers of insurance to go bare. As "Forbes" magazine put it not too long ago, "a world without insurance" would result.

In order to keep increases within some degree of reason, the loss side of the equation must be dealt with. And it is here that public pressure for civil justice reform must be brought to bear.

In a number of states business coalitions have been formed to review the trends which have developed over the past decade and to recommend legislative remedies such as restrictions on punitive damages, limits on contingency fees, elimination of joint and several liability in short, they want what we want: the return of reason and common sense to the civil justice system.

The Insurance Services Office is proposing several changes which could have long-range benefits to the buyer. One is to give insurers (and their buyers) the option of using a "claims made" policy. This option will permit insurers to put a more realistic price on the commercial liability product as it eliminates the uncertainty brought about by claims discovered today that are due to occurrences which happened years ago.

The insurance industry is cooperating with state regulators, not conspiring with them, to develop open lines, market assistance plans, joint underwriting associations, and risk pools to name a few of the voluntary and unilateral actions being taken to address the crisis.

Finally, to complicate the availability crisis by confusing further the ability of insurers to assess their reserve requirements is the ill-timed tax reform legislation now making its way through Congress.

Current proposals to "reform" the manner in which insurers pay taxes on reserves and tax exampt investments will mean lower pools from which insurers can draw to pay claims made by policyholders. If pools or reserves are reduced through the taxing process, then premiums will have to be raised, exacerbating the availability/affordability crisis.

Mr. Chairman, this concludes my testimony. Thank you for inviting us to testify on this very important issue.

The **Chairman**. Thank you.

Mr. Mansfield.

Mr. **Mansfield**. Thank you very much, Senator.

What I might do briefly is touch on three issues. One would be a generic description of mutual insurance companies since I am here representing the Alliance of American Insurers. In addition, I am representing my own company, Liberty Mutual.

Second, I would like to make a few comments about Liberty Mutual which might brighten some people's days among all this gloom and doom about the insurance industry.

And last, a brief comment about the civil justice system.

All insurance is essentially mutual, in that policyholders pool their risks and pay premiums to pay the losses of a few. However, it has been said that mutual insurance is the purest form of insurance. The earliest mutual insurance company in the United States was founded by Ben Franklin, and it was called the Philadelphia Contributorship for the Insurance of Houses from Loss by Fire; and that mutual insurance company continues in business today.

As originally designed, the contributorship insured houses by accepting deposit premiums for a period of 7 years. At the end of 7 years, if there was money left in the account, the money was returned to the policyholder members as dividends. Essentially, this was insurance at cost.

In a mutual company, the policyholders have an interest in the operations of the company, much as the stockholders in an investor-owned insurance company do. However, this interest is fundamentally different. While often compared to stockholders, the policyholder in a mutual company does not make an investment. Rather, he seeks to obtain insurance protection and services at a reasonable cost.

Thus, any participation he has is limited to obtaining those services at a reasonable cost, making sure there is sound management of the company. If a policyholder cancels a policy or fails to renew, he has received all the benefit he can from that contract.

Of course, at times for a mutual policyholder, his interest as a policyholder can conflict with his interest as a manager of a company. If he manages his daily enterprises in a negligent way, he obviously needs insurance protection. As a member of a mutual company, he would obviously want to have the insurance company cancel him or offer him lower limits.

We talk about the cycles in recent years and increased hazards and risks. However, as an historical note, you should know that Ben Franklin was charged a premium 300 percent higher than some other members of the Philadelphia contributorship because he stored paints and oils in a house he rented to someone else.

A final key difference between mutual and stock insurance companies is the access to capital markets. Stock insurance companies have ready access to the issuance of additional stock through the capital markets. Thus, as stock insurers proceed through the underwriting cycle, as someone said this morning, nearly $5 billion in new capital has entered the industry.

That can come from investors in the case of a stock company. In a mutual company, it can only come from one source. That is from retained earnings or increases in surplus. Thus, over time the only way for the mutual insurance industry to grow is to have sustained profits, again over a period of time.

For a moment now let me talk about Liberty Mutual. I am well aware of the gloom and doom. I am well aware of the perceived crisis. But from Liberty Mutual's perspective, we have been expanding in 1985. Our business was up.

Our written premium was up 36 percent, and that is not just premium increases. That is also real new exposures. We are insuring a lot more people and businesses. It is a response to the level of growth.

In terms of day care centers, we had never insured day care centers. They had been a specialty market. The insurance department in Massachusetts came to us and we sat down in early September 1985, wrote a day care policy, got it approved, and we are offering it now in Massachusetts. We are also offering it in other States through their market assistance programs.

In terms of the loss prevention activities that Mr. Nader felt were important, well, again, in my submitted testimony there is a little history of Liberty Mutual. In our original enabling legislation of 1911, we are mandated to carry on loss prevention activities.

Some of the first employees of the company were loss prevention engineers. In fact, right now we have approximately 500 safety engineers who continue to inspect premises for life hazards and other liability hazards. And we also operate a research laboratory in Hopkinton, MA, that does a lot of research into ergonometrics, skid safety, and things like that.

We were fortunate enough to have our Best's rating increased to A-plus within the past year or 18 months, too. So again, for me Liberty Mutual is a bright spot in the industry.

A quick word on civil justice reform. There has been talk of rolling back the system to the dark ages, and there are cries from various people that the insurance industry is blackmailing State legislatures. Let me quote you something that Judge Learned Hand said. He said: "Justice is the tolerable accommodation of the conflicting interests of society."

Right now the interest of society, that of the business community, that of the general public, that of thoughtful public policymakers, is merely saying the civil justice system is no longer a tolerable accommodation, but an intolerable intrusion. I think we need to address that.

There are a great many areas of common ground, and all we are saying is let us find that tolerable accommodation.

Thank you very much.

[The statement follows:]

STATEMENT OF CHRISTOPHER C. MANSFIELD, VICE PRESIDENT AND GENERAL COUNSEL, LIBERTY MUTUAL INSURANCE CO.

I would like to focus on three areas during my comments today. First, a generic explanation of the concept of a mutual insurance company, with a brief historical overview. Secondly, a more detailed account of the history of my company—Liberty Mutual, and lastly, a few observations regarding the civil justice system.

There are several forms of property and casualty insurance companies. The two largest types, writing the vast majority of the insurance in the United States, are mutual companies and stock companies. My role is to try to present a brief overview of the mutual company.

First, however, both mutual and stock companies engage in the four principal branches of insurance: property and fire; casualty and liability; life and health; and marine. Also, both are subject to the general corporation and insurance laws of the states in which they operate, with some technical differences.

All insurance is essentially mutual in that all policyholders pool their risks by paying their premium and pay losses to a few. However, it has been said that "mutual insurance is insurance in its purest form." [1]

The earliest mutual fire insurance company [2] in the United States was founded by Benjamin Franklin in Philadelphia in 1752. It was named "The Philadelphia Contributorship For the Insurance of Houses From Loss By Fire" and continues in business today. As originally designed, the Contributorship insured members houses by collecting seven years of premium. Initially, up to one half of the funds collected could be invested and, in fact, were loaned to a merchant. If any losses occurred, the losses were deducted from the pool of money available from the deposits. If still more money was needed, the members were assessed. At the end of seven years, any money left in a member's account after payment of losses and expenses was returned to the member as a dividend. Thus, mutual insurance was and is essentially insurance at a reasonable competitive cost.

In a mutual company, the policyholders have an interest in the operations of the company. This interest is exercised by electing the Board of Directors at annual meetings. The Directors then select the management for the mutual company and are charged with the legal responsibility for the management and control of the business.

Policyholders, as members of a mutual company, also have the right to participate in dividends to the extent declared by the Directors and have certain property rights with respect to the surplus of the company in the event it ceases to operate as a mutual company.

While policyholders of a mutual insurance company are often compared to stockholders in that both are owners of the company, the purposes of ownership are fundamentally different. A stockholder is an investor in the enterprise and places his money at risk with the expectation of deriving a suitable return on the investment.

A mutual company policyholder, on the other hand, does not make an investment in the company but rather seeks to obtain insurance protection and services. Thus, any participation is with the objective of assuring sound management so that the protection and services are provided at a reasonable cost. If a mutual policyholder cancels or fails to renew a policy, he has received the full protection for which the premium was paid. There has been no risk of capital.

There are circumstances under which a mutual company policyholder's interest in protection can conflict sharply with his interest as an owner. For example, he may operate his business unsafely with respect to matters within his control or wilfully act in such a way as to be likely to cause harm to others. As a policyholder, he will want and need insurance protection, but as an owner, he would expect the company to charge an appropriate premium for higher than average risks or cancel his insurance. As an owner, he would owe an obligation to other members not to injure them by failing to pay premium, making a false application, filing a fraudulent claim, or incurring excessive losses. While a stockholder's relationship with the company cannot be terminated except by purchase of his interest, a mutual company member's interest can and should be terminated in the interest of other members if he violates his obligation as a participant in the enterprise.

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[1] Biography of An Idea, The Story of Mutual Fire and Casualty Insurance, John Bainbridge, Doubleday & Co. (Garden City, N.Y. 1952) page 19.

[2] Although the mutual concept dominates the life insurance industry with companies such as Metropolitan, John Hancock, Northwestern, Massachusetts Mutual, and others, the focus of this hearing and testimony is property and casualty insurance.

In fact, in 1752, The Philadelphia Contributorship embodied these same principles. Benjamin Franklin, one of the founders, sought to insure two houses that he rented to others. The Contributorship would not insure buildings without a prior inspection by master builders. This was the first Loss Prevention program, still an integral part of the mutual property casualty industry. In any event, upon finding a tenant who stored paints and oils at one location, the Contributorship charged Franklin the highest rate allowed due to the increased risk. Thus, even a key founder and respected figure as Ben Franklin found himself paying nearly 300% of the lowest rate due to an increased risk.

The last key difference between a mutual and stock insurance company is the access to capital markets. Stock companies, operated for the benefit of investors seeking a return on invested capital, can expand to meet the needs of a growing economy or increased demand by issuing additional shares of stock. Many stock insurance companies did this in 1985. Mutual insurers do not have this ability to issue stock. Any growth must be financed internally through retained earnings and surplus accumulation. The property-casualty insurance industry as a whole suffered an operating loss of $5.5 billion in 1985 according to the Insurance Services Offices. Stock companies can replace any loss of surplus and capacity by access to the capital markets. The mutual industry needs profits to accumulate the capital to meet the needs of an expanding economy.

Permit me to focus for a time on Liberty Mutual. As with most companies, it is really a group of companies with the two major entities being Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company.

Liberty Mutual is a creature of the Massachusetts legislature originally called the Massachusetts Employees Insurance Association as a section of the newly enacted Workmen's Compensation Act in 1912. At first, Liberty Mutual could only write workers compensation insurance in Massachusetts. However, on April 29, 1915, it was granted the right to write "Public Liability" insurance and in 1916 it was permitted to write insurance outside Massachusetts. In 1917, during World War I, the company changed its name to Liberty Mutual.

Liberty Mutual Fire Insurance Company was founded in 1908 as United Druggists Mutual Fire Insurance Company to insure the druggists of the Rexall chain. Essentially, this was a reaction to the ridiculously high rates druggists were being charged by stock companies at the time. In 1918, United and Liberty entered into an agreement to write a comprehensive automobile insurance policy covering fire, theft, collision, and liability. This affiliation caused United to drop "Druggists" from its name in 1918 and change its name to Liberty Mutual Fire Insurance Company in 1949. Both companies have issued only non-accessible policies since 1943.

Let me mention two developments so you won't think that all mutual insurers are rooted in colonial times or the industrial revolution. Within the past several weeks, an association of nurse midwives, unable to find acceptable malpractice insurance coverage decided to form a mutual insurance company. Also, a number of day care providers are exploring the possibility of forming a mutual insurance company for their insurance needs. The mutual concept, with appropriate regulatory supervision, has as much vitality today as in Ben Franklin's time.

Liberty Mutual, in addition to its Board of Directors elected by the policyholders, has 30 regional Advisory Boards totalling over 300 policyholders. These Advisory Boards meet quarterly with regional managers and senior executives as representatives of local policyholders to assist the company in protecting and furthering the interests of policyholders.

Today Liberty Mutual is an international company with over 19,000 employees. In 1985 Liberty Mutual wrote over $4 billion in premiums. Of these $385 million were for the general liability line of coverage. Liberty Mutual also paid its policyholders $195 million in dividends and managed to increase surplus by $134 million to $1.66 billion.

Not all of the property-casualty industry was as successful and despite these satisfying results for our company, we also recognize some of the basic problems in the United States liability system since, Liberty Mutual's earnings statement also reveals that we lost $483 million in 1985 from the underwriting of insurance.

Judge Learned Hand once defined justice as "the tolerable accommodation of the conflicting interests of society." Yet, at this juncture of our history, there is a growing consensus that this "accommodation" is no longer "tolerable" but rather an intolerable intrusion to many individuals and businesses. Reform of the civil justice system is the focus of business groups, intellectual conferences, insurance companies, physicians associations, and enlightened regulators and legislators across the country. There is an objective unfairness and intolerable economic burden in our current tort compensation system. Additionally, the legislative risk, the regulatory risk, the judicial risk, combined with the traditional underwriting risk and social and economic inflation make it totally imprudent for an insurer to accept certain transfers of risk in today's environment.

The civil justice system needs reform. Some interests will cry out against the alleged tyranny of "cutting back" victims rights. Thoughtful legislators will accept such complaints for what they are—special interest groups protecting their special interests. Thoughtful legislators will look back in history to two other times when the liability system was out of control and victims "rights" to sue in certain circumstances were altered to achieve a larger public goal. Beginning in 1911, workers' compensation acts removed an employee's right to sue his employer and provided a fixed schedule of benefits. Now all 50 states and the federal government have workers' compensation acts funded by insurance which have largely internalized costs. In 1970, no-fault insurance limited a victims right to sue for certain injuries suffered in automobile accidents in favor of a fixed compensation package. Now over half the states have no-fault insurance. Both these systems were opposed vehemently by lawyers as curtailing victims rights (and lawyers fees). Nevertheless, a greater public need, the need for reform of a crowded, inefficient, expensive, slow and lottery-like liability system convinced thoughtful legislators to serve the entire body politic, thereby enacting lasting, meaningful reforms.

I submit to you that 1986 is a watershed year. It is the beginning of reform movement in the civil justice system. A movement that must lead to better balance between victims rights and society's need for stable, certain compensation systems. We must return to Judge Hand's "tolerable accommodation".

The **Chairman**. Gentlemen, thank you very much.

We have heard today that the insurance business is cyclical, that there has been a particularly bad downward swing in the cycle, that it has been caused by the insurance companies betting on high-interest rates, reducing premiums, trying to get cash in to put in investments, and causing some underwriting losses as a result of that.

We have also heard that, despite the downward swing, the insurance industry is profitable, that many insurance companies are making money, that the stocks of insurance companies are selling very well and have appreciated considerably.

I suppose that if that were the basic determination or finding of this committee, the result of it would be to do nothing, to ride it out, to let any problem right itself.

What would be your comment in that regard? Do you think things are going to get better, and do you think that it would be a mistake for Congress to barge into this area? Do you think that Mr. Nader is correct, that any problems are ones of conspiratorial nature or bad acting by the insurance companies?

What is your advice?

Mr. **McCormick**. There is no collusion that I can see in this industry. If anything, over the last 4 years we have had an informal mutual suicide pact. You do not go through cycles like this because you are working together; companies, frankly, were about to go under if underwriting and prices did not change. The recovery is very sharp and unfortunate for the insureds, but it is a necessary ingredient to keeping the companies solvent. We did not have time to have a long recovery. Each company was acting for self-survival. This is probably the most fragmented and competitive industry in America. That is why the returns on equity have been low over time.

I think I have stated my feeling to this committee, saying that the market will self-correct and will recover. By the time we are into 1987, there will be only a sliver of the market, 1 or 2 percent that cannot be covered.

The **Chairman**. Well, then we should ride it out?

Mr. **McCormick**. Yes.

Now, if I might take 1 minute, I would like to make a separate comment on the tort issue.

The tort situation in this country is not a solution to the insurance problem per se.

The loosening of our tort system is, however, driving up the overall cost of coverage and has been over time. It is raising costs and is creating a hidden tax on everybody. I say that because as long as we have predictable laws, then insurance can be made available. People might not like the costs, but as long as we know what the laws are and it is possible to spread the risk, insurance companies can function. Of course, the looser the laws, the greater the costs.

I would say the basic issue on tort reform is this: There are seeds of things happening today which are going to make our tort system and the definition of liability an exploding issue in this country. Congress will end up in the middle of the debate because our legal system is so much at the core of the freedoms guaranteed by our democracy. The core problem is that attitude of entitlement spreading and defenses are weakening. For example, in the worker's compensation area, which is not a tort issue so much as it is a no-fault way to pay for damages that are incurred, people are beginning to sue for everything. They say: "Job stress made me an alcoholic, or my eyesight got weaker from reading on the job."

Don't laugh. These cases are now showing the first signs of being collectable in court. If you project this trend out, particularly as our population gets older; then we are heading for very serious societal problems. What if everyone sued for old age?

The **Chairman**. But all the horror stories, the difficulty of getting insurance, the fact that somebody's premiums went up 200 percent, 300 percent in a year, does that derive largely in your opinion from the tort problem or from something else?

Mr. **McCormick**. A lot of it is simply we were charging way too little a year or two ago. I think the Tillinghast representative, Mr. Beer, said it right. If the price dropped 50 percent, then to get back to where you were you must have a 100-percent increase. Statistics can be misleading. We are only just now reaching the ISO manual rates in most lines. For example, in commercial auto, we had loss ratios of over 200 percent, so the prices had to go up by a factor of 2½ to 3 just to have losses less than premiums. In many instances, we are charging only one-third of ISO recommended rates. I will leave it to others to explain how this happened.

But over the longer term tort law is driving insurance costs up because it is creating so much uncertainty and settlements continue to grow. Only 4 or 5 percent of tort cases get settled in court. Everybody else settles out of court, assuming inceased liability will apply. You know, people are frightened of the court. In fact, one trial lawyer in California said he gets settlements 10 times what he should because people are afraid of going to court.

The **Chairman**. Does anyone else have any comments?

Mr. **Martin**. Yes. We suggest, in looking at tort reform, you do not only look at the insurance system. We do have problems with regard to long tail lines in terms of pricing predictability, and there will be continuing market problems for those kinds of lines, we think, for some time to come, looking at our own orientation as a commercial lines writer.

But in addition, tort reform should be viewed also from the standpoint of the public and from the standpoint of manufacturers, municipalities, and professionals. Somehow or other, fairness must come back into the tort system. We submit that some of the doctrines that have been court-created have not been examined by legislatures. They have been court-created case by case, and so what some of us regard as a house of cards has been constructed over the years.

The impact on society of all those individual decisions has not been looked at. Now, if you look at them today, we think you have to look at the impact on some of the professions. In State after State, we are hearing about obstetricians no longer willing to stay in practice. We are hearing volume manufacturers not willing to put their products on the marketplace.

We are hearing about design engineers staying with designs that are 5 and 10 years old because they are safer, and they may not be. Society is being denied the benefits of innovation and change and professionalism, at very great cost. And these costs need to be examined.

The CHAIRMAN. Senator Ford.

Senator FORD. Mr. Chairman, several things bother me, and I guess it is because of some knowledge and background that I have had. The word "predictability" keeps coming through, and I understand we would all like to have some predictability, and in our society that is very difficult to do.

You might be able to find a floor somewhere, but I do not know whether you could put a cap on it or not, and I think the cap is predictability.

Mr. Martin, let me ask you a question. And I will kind of bounce around a little bit, Mr. Chairman. Should the foreign insurance industry be regulated by the States? You got into that a little bit in your testimony, and I just wanted to see what you thought about it.

Mr. MARTIN. Yes, Senator. This is a very fragile business, in the sense that capital is attracted to where capital sees an opportunity. If regulation impairs that opportunity, capital will not be attracted. There is the great danger that if you submit what is not unregulated to regulation—and there are different kinds of regulation.

Senator FORD. There is good and bad.

Mr. MARTIN. Yes, sir. And if you threaten the viability of the capital by suggesting that you are going to impose pricing limitations or underwriting standards, I do not think you will see capital attracted, or you will see much less capital attracted.

So, the answer to that question is we would hope that that is not an avenue for further exploration.

Senator FORD. What steps, if any, should States' regulators have taken to help to avoid what we see or what the public perceives as dramatic swings in the property and casualty insurance market?

Mr. MARTIN. That is a very important question. There are regulators now who are addressing what they can do for the future to provide some protection against wild swings in terms of pricing.

Please keep in mind that many of the changes in price that people are complaining about are just that. They are changes in price, not rate. Rates, the basic rates made though normal ratemaking techniques have gone up fairly regularly over the last several years.

What has gone down has been price, because companies trying to compete with other companies, driven by low-cost reinsurance and low-cost excess markets, have underpriced their business. They have done so through filed rating plans which permit the exercise of judgment, as much as 50 percent up, 50 percent down, on an individual risk basis.

Now, earlier I think I mentioned the competitiveness of this business. It is competition in the marketplace that drives these kinds of marketplace activities. The regulators now are looking at ways in which they can limit those swings in pricing, recognizing that rates have to be adequate in order to attract the commercial lines market.

And perhaps that is the direction in which regulation will go. We think it will and we are supporting efforts in that direction.

Senator FORD. What you are saying is there are basic rates that you have in a manual and you rate, for example, certain occupations and there is no collusion about that. You have an independent agency that goes out and says this is the rate and then you file for a discount or the ability to give a discount.

And now, after you discount so drastically, you want to get back to manual rates. You get back into manual rates and it seems like it is a very large increase. But if you had stayed at manual rates over the last several years, you would find that the insurance industry would be in a better position than it is today, or that the people would not be concerned about it.

Municipalities talk about the company; they lost their insurance. But all they do is say they have lost it. They fail to go to that independent agent out there and say, "Hey, we lost our insurance. We need some help. Can we get some bids on it?" So, you find within 15 to 20 days, you get two or three offers and the muncipality will have an opportunity to make a judgment, or you can still bid. It does not eliminate the bidding.

If a company is willing to take it, they will take an offer. So, predictability is one thing.

Mr. McCormick, let me ask you. How do you like the insurance business compared to American Express?

Mr. MCCORMICK. I like it, and I have been in lots of businesses——

Senator FORD. You do not look that old.

Mr. MCCORMICK [continuing]. Looks are deceiving. I worked as a physicist for Admiral Rickover here for 5 years back in the sixties, so I have had some interesting people to work with. And insurance is one of the hardest operations I have had to manage because the costs are so unpredictable.

I would like to just pick up your question about what can be done. This is an industry, where because costs are uncertain, our reserves and our balance sheets have to be very disciplined.

I think what has happened is companies took parts of their balance sheets through the income statement and got into worse trouble than necessary. Then they had more to catch up on the upside.

Senator FORD. I am sorry the chairman came back. I thought I was going to be able to continue with this, but go ahead.

Mr. McCORMICK. If every company maintained full and adequate reserves at all times, we would discover our problems more quickly. As I said, we found we were $600 million short in reserves. Cigna has announced a $1.2 billion addition; Continental, $220 million. If people had known these problems years ago—when they occurred, the swings would not have been as extreme. The question is, How can we prevent that happening? Some tougher accounting discipline is needed.

Senator FORD. Well, let me ask you this. Isn't it relatively difficult for an insurance company to be sure of its financial stability?

Mr. McCORMICK. Yes.

Senator FORD. You have claims that occurred, and all of a sudden a latent injury that happened 30 years ago results in a required payment.

Mr. McCORMICK. We just paid a big one for Todd Shipyards from 1943.

Senator FORD. Yes; so there is difficulty at its best to keep your financial stability.

I am not sure better bookkeeping, unless you would cut off 20 years back, would help with your predictability. There is a statute of limitations on some things, but what about the cases of 1943?

Here it is, 43 years later. You are being sued for something that occurred at that time.

Mr. McCORMICK. But these older cases typically only amount to a few percent difference in our reserves. If we came consistently within 3 or 4 percent, that would be very good shooting.

Our problem is that when we are off by 15 or 20 percent, we then can be in serious trouble. ISO has estimated that the industry, just before this last round of additions, was 15 percent underreserved. That means that the industry overstated earnings over the last 5 or 7 years by that amount of money, and that led to people thinking they were making more money than they were. Then, when they found they were out of reserves, they had a far bigger problem than they thought.

We need very disciplined accounting and very disciplined balance sheets. That would keep the cycle more disciplined and lessen the fluctuations.

Senator FORD. Mr. Chairman, I would like to ask just one more question and then I will stop.

Mr. McCormick, is tort reform the basic problem you have, or are there other problems that need to be addressed?

I think, Mr. McCormick, you were getting to that. You have some thoughts, I think, about what the State legislature might do with respect to the workmen's compensation laws that are passed in individual States.

Do you want to preempt the States? Do you want to leave them like they are?

Mr. McCORMICK. The immediate problem is surviving this cyclical correction. The longer term and greater problem for our society, is correcting the tort system. The tort problem has been building over the last 20 years. This cycle, simply because of unavailability of insurance, has made the tort issue public. If we fix the tort system tomorrow, over time it would lower insurance prices because it would lower costs; but it is not a panacea.

You know, this tort mess is relatively new. Until 1962 our tort system was very similar to England's. After all, it came out of English common law.

Since 1962 our courts, without any public mandate, without any debate, have fundamentally rewritten almost every major legal doctrine that underpins our tort system. It has happended very quickly and very quietly, precedent by precedent. The system we have today is very different from English common law, which by they way, we in America had kept largely intact from the time of our revolution until 1960.

Something very fundamental happened between 1960 and today, and that is why I urge this body and others to look into and support, changes to our tort system. The problem is growing exponentially; what you see today is just the tip of the iceberg. All the people who are eligible to sue under the current rules are not, but as they learn that the door of the vault is kind of open, more and more will find ways to make money from our tort system. We are just beginning an exponential runup of tort cases. I think it is a serious problem in the making for our society and our country.

Senator FORD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, gentlemen, very much for very helpful testimony.

Next we have a panel. We have panel one. I want to apologize to everyone for the long day it has been for you.

Mr. Jay Angoff, National Insurance Consumer Organization; and Ms. Mavis Walters, Insurance Services Office.

Mr. Angoff, thank you.

STATEMENTS OF JAY ANGOFF, COUNSEL, NATIONAL INSURANCE CONSUMER ORGANIZATION; AND MAVIS A. WALTERS, INSURANCE SERVICES OFFICE, INC.

Mr. ANGOFF. Mr. Chairman, I wonder if I could take questions after my statement?

Thank you for the opportunity to testify here. I would like to mention a few things. No. 1, we strongly support your idea of expanding the Risk Retention Act. I think that the more broadly it is expanded, the more businesses it takes in, the more of the problem it will solve.

No. 2, there are a number of areas on the Federal level that we think you should look at. We do not necessarily have all the answers as to how you should deal with it, but we think that you should look at, for example, the antitrust exemption.

The way the antitrust exemption works under current law, as one of the gentlemen on the last panel said, is that insurance companies cannot boycott. That is, they cannot get together and decide we are just not going to write insurance at all. That is unlawful. That was held in the *Barry* case, the Supreme Court case a few years ago. Four medical malpractice insurers did get together and say we are just not going to sell insurance to doctors at all. That is illegal.

But what is legal is, they can fix prices. That is, they can get together and say tomorrow we are going to raise our prices by 500 percent to doctors. That is legal.

We do not know whether that is done, but we think that that aspect of the law should be looked into.

The other thing is this; that on the Federal level there is no Federal regulation whatever, no Federal monitoring, and that may be all right—that is, no Federal rate regulation, no Federal consumer protection regulation—that may be all right, but it does leave a very big job for the State insurance commissions and departments to do, and the GAO found in 1979 in a very exhaustive study that they just were not doing the job.

I do not know how much followup there has been to that, but I think possibly one thing that you might want to look at it is the Federal Government not regulating the insurance industry, but at least setting minimum standards for State regulators to meet.

Another thing we are concerned about is the cyclicality of the industry is well-known but we are afraid that, for example, the antitrust exemption might exacerbate the cycle; that is, may make rates go up more at the bottoms of the cycle than they would otherwise.

The other thing that we do not understand is the stock price movements despite the cyclicality of the industry. Insurance stocks just keep going up, although insurance company profits go up and down. Since 1975, the stock price property casualty index has gone up more than 500 percent. The Dow has not even doubled, and we do not understand why that is, but I think you should take a look at it.

Possibly more important than anything else is, we think you should get the data; that is, you should find out how much insurance companies take in and how much they pay out year after year and State by State and line by line.

Now, we have sporadic data that indicates that there might be in some lines a problem. For example, New York City in 1985 paid out $150 million. That is twice as much as they paid out in 1983 and they say they are going to pay out $500 million in 1990.

Now, that is only the first step of the problem but that does show anyway that New York City is paying out more. The reason we have that data is because New York City self-insures. There is no insurance company.

On the other hand, there are many States in the country where the data indicates there just is not a problem. I was in New Hampshire yesterday. In New Hampshire, people just do not sue. There are 6,000 suits filed a year. The suits have actually gone down in the last 3 years in 8 of the 10 counties. The highest verdict is between $30,000 and $450,000. The insurance industry recognizes that. In a newsletter they said, how good was 1984 in the property casualty industry in New Hampshire? To say it was a good year would be an underestimate.

So, in New Hampshire there is not a problem. In Nevada there have been three medical malpractice plaintiff's verdicts in the history of the State; yet, doctors still cannot get insurance—I mean in New Hampshire. In New Hampshire, by the way, we are seeing the same thing happen as we are in the rest of the country, despite the fact that the data shows that people do not sue and people do not recover a lot of money. The same in Nevada, the same in South Carolina.

In Pennsylvania there is a statute which dramatically limits the liability of municipalities; yet, in Pennsylvania municipalities still cannot get insurance.

So, that is the data that shows us that the problem is certainly not one entirely of tort reform, certainly is not linked to the tort law. I think also you should very seriously consider the studies that have been done that show what happens when tort reform is enacted.

There was a study done by a Frank Sloane from Vanderbilt and Duke Journal of Health Politics who analyzed the tort reforms that were instituted in the mid-seventies, and found out that there was no effect on insurance premium rates. And there is also the Canadian situation and there are other situations I think that should be looked at seriously.

The final point is this. Mr. Chairman, I think what you are doing in the product liability area; that is, setting up a working group to look at all aspects of the system, is good. People on both sides give up something and they get something.

I do not want to minimize the practical or political problems. They are severe. But we favor that concept and I think you might consider doing the same thing in this area; that is, to look at both the tort law and the insurance law, and it is just possible that if people on both sides give something, that maybe you can come up with a good package of reforms that many people would support.

Thank you.

The CHAIRMAN. Well, we do hope to get some support. You know, we have had a group that has been working on the product liability issue and it has had a couple of drafts. The most recent one is S. 1999.

We do hope eventually, hope in the near future to mark that up, but we are still open for comments on that and any input would certainly be welcome.

But you have raised a lot of questions, and I have a lot of questions, too. But what is your answer? You do not think that the answer is tort reform, but what is it?

Mr. ANGOFF. We have suggestions that we believe would go a long way toward solving the problem. I think one is expanding the Risk Retention Act. We think another is at least modifying the McCarran-Ferguson antitrust, as Senator Simon suggested.

We think a Federal reinsurance program would solve much of the problem. We think that one way or the other, State regulation——

The CHAIRMAN. By that, you mean get Uncle Sam in the business of reinsurance?

Mr. ANGOFF. That is right. It would be funded by the insurance industry, but run by the Government. When we argue for it, we point to the example of the Riot Reinsurance Program that made money. When the industry argues against it, they point to the example of the Flood Program which lost money.

So, it could either make money or lose money. The point is that there is precedent for it and that it is a legitimate concept.

I guess our major point is this, though; that before you do anything, you have got to have the data. You have got to know how much insurance companies pay out for the average medical malpractice claim, for the average product liability claim year by year and State by State. After doing that, I think, then that will enable you to determine what the problem is.

The **CHAIRMAN**. Mr. Angoff, thank you very much. You are at the end of your time limit, and I very much appreciate your being here today.

Mr. **ANGOFF**. Thank you very much, Mr. Chairman.

[The statement follows:]

STATEMENT OF JAY ANGOFF, COUNSEL, NATIONAL INSURANCE CONSUMER ORGANIZATION

Mr. Chairman and members of the committee, the National Insurance Consumer Organization is grateful for the opportunity to testify on practices of the insurance industry, and laws and regulations relating to the insurance industry, that may have contributed to the sharp premium increases and refusals to deal in the insurance market that we are seeing today.

I. DATA COLLECTION

The first step in determining the cause or causes of premium increases and refusals to deal is to get the data. Specifically, this Committee should invite the property/casualty insurance industry to disclose the number of claims paid, and the average size of those claims, year by year, line by line, and state by state. It may be that for some lines, and in some states, the number and size of claims paid has dramatically increased in recent years, thus indicating that non-insurance industry factors may be in part responsible for insurance industry increases and refusals to deal. On the other hand, the number and size of claims paid may not have increased dramatically, thus pointing to internal property/casualty industry factors as the cause of such increases and refusals.

The point is that legislators must have the data in order to begin to assign responsibility for the current conditions in the insurance market.

II. EXEMPTIONS FROM FEDERAL LAW

Second, this Committee should determine the extent, if any, to which the following privileges of the insurance industry have contributed to sharp premium increases and refusals to deal:

1. The insurance industry's exemption from the antitrust laws under the McCarran-Ferguson Act.—Insurance companies can legally raise their prices in concert without fear of antitrust prosecution. Executives in other industries who raise prices in concert can go to jail for three years.

2. The insurance industry's exemption from federal rate regulation.—Congress has on occasion exempted other industries, such as trucking and railroads from the antitrust laws, but has substituted federal rate regulation for antitrust enforcement as a means of keeping rates down. The insurance industry is unique in being exempt from both antitrust enforcement *and* federal rate regulation.

3. The insurance industry's exemption from federal consumer protection regulation.—Insurance companies can engage in unfair or deceptive trade practices without fear of Federal Trade Commission prosecution. In addition, in 1979, after the FIC published a study critical of whole life insurance, Congress prohibited the FTC from even studying the insurance industry.

4. The property/casualty insurance industry's exemption from federal taxation.—According to an October, 1985, U.S. General Accounting Office study, the property/casualty insurance industry had net gains of $75.2 billion during the period 1975–1984, yet paid no federal income tax and in addition received a $125 million tax refund from the government.[1]

There may be legitimate reasons for some or all of the above exemptions. Our only point is that Congress should examine these exemptions to determine whether, and to what extent, they may facilitate sharp premium increases and refusals to deal.

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[1] *See* U.S. General Accounting Office, "Tax Administration: Information on How the Property/Casualty Insurance Industry is Taxed" (October 1985).

III. STATE REGULATION

Since the federal government can neither regulate nor monitor the insurance industry, and since private individuals may not sue insurance companies for price-fixing under the antitrust laws, the only entities with the authority to control insurance company practices are the state insurance commissions or departments. Both the willingness and ability of state insurance commissions to meaningfully regulate the industry have been questioned. In 1979, for example, the GAO found that "there are serious shortcomings in state laws and regulatory activities with respect to protecting the interests of insurance consumers in the United States." Specifically, the GAO found:

a. "most states do not have specialized examiners and few states have the capacity to do computerized audits";

b. "the authority of departments to order corrective action is very limited";

c. "the degree of scrutiny given important premium increase requests varies among the states. Among those [17 states] GAO examined, only Texas and Massachusetts conducted an original actuarial analysis enabling them to independently recommend the appropriate level of insurance rates";

d. "insurance regulation is not characterized by an arms-length relationship between the regulators and the regulated";

e. "in general, the number of individuals on insurance department staffs with relevant professional training is small." [2]

NICO believes that this Committee should determine for itself whether state insurance commissions are willing and able to meaningfully regulate the industry. It should also determine the extent, if any, to which the following state laws may have contributed to skyrocketing rates and refusals to deal:

1. State statutes or regulations that prevent or discourage businesses, consumers and municipalities from joining together to buy insurance as a group or to self insure;
2. State statutes or regulations that prevent banks and other financial institutions from selling insurance;
3. State statutes or regulations that permit rate increases to take effect without being approved by the state regulator;
4. State statutes or regulations that permit insurance companies to set rates without taking into consideration the past claims experience of the insured;
5. State statutes or regulations that permit mid-term cancellations or refusals to renew without notice.

Legitimate reasons may exist for protective state regulation for the insurance industry, just as legitimate reasons may exist for exemptions from federal law for the insurance industry. Congress should very carefully examine such exemptions and protections, however, to determine their effects.

IV. THE CYCLICAL NATURE OF THE INSURANCE INDUSTRY

The insurance industry is cyclical, as indicated by Chart I, attached as Exhibit A.[3] Insurance companies cut their premiums and insure bad risks when interest rates are high, in order to get more premium dollars to invest; they raise their premiums when interest rates are low, and must raise them even higher when they must pay off on some of the risks that they unwisely insured during the high interest rate years.

In 1981, for example, with both interest rates and their rate of return at about 20%, insurers were "begging for business, at any price, to get premium dollars to invest," according to the president of a large New York insurance brokerage.[4] Insurers even wrote policies for those harmed in the Las Vegas MGM Grand Hotel fire—after the disaster occurred.[5] They believed they would earn more by investing their premiums immediately than they would lose by paying out claims in the future. (Had insurers not cut premiums after 1980, but had merely held them constant, their rate of return both between 1981 and 1983 and for the period 1976–1983 would have been at least 30%. *See* Exhibit B.)

Today, on the other hand, interest rates have declined. The industry finds itself paying claims on policies that were written back in the days of hyperinflation, when its rates were too low. So, just as it did in 1976, during the last insurance cycle bottom, the industry substantially raised rates—by an average of 72% for general liability policies—[6] and reduced coverage.

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[2] *See* U.S. General Accounting Office, "Issues and Needed Improvements to State Regulation of the Insurance Business" (October 1979).

[3] The exhibits were not reproducible and are in the committee files.

[4] "Taming the Insurance Industry's Booms and Busts," The New York Times, October 20, 1985.

[5] *Id.*

[6] Best's Insurance Management Reports, release No. 31, December 30, 1985, at 9.

Attached as Exhibit C are several quite candid comments of high level insurance executives about the "inevitability" of the insurance industry cycle and the "overreaction" of the industry to competitive pressures (see comments by CNA chairman Noha), the "almost total disregard for pricing adequacy and risk retention" by insurance companies in recent years (see comments by Atlantic Companies president Trowbridge), and "basic greed of new-found capital" in the insurance industry (see comments of Hartford president Frahm). This Committee should consider whether there are actions Congress could take to counteract the above problem. It should also determine the extent to which the industry's exemption from federal law and protection under state law may have exacerbated the insurance industry cycle.

V. THE FINANCIAL CONDITION OF THE PROPERTY/CASUALTY INDUSTRY

While the insurance industry's profitability may rise and fall, insurance industry stocks just keep on rising: since 1975 the property/casualty stock index has risen about 500%, while the Dow Jones industrial average did not even double. And during 1985, as insurers tripled and quadrupled premiums and reduced coverage, the property/casualty index rose by 50%, about twice the rise in the Dow. (*See* Chart II, attached as Exhibit D.)

Perhaps the most apt characterization of the property/casualty industry's financial health appeared in the January 24, 1986 National Underwriter (at 2). Said Thomas K. Meakin, NU's resident expert on the financial health of the industry, under the headline "1985 a year of Glittering Glory":

"It was acres and acres of diamonds for owners of insurance stocks and financial services issues as our favorites sparkled in 1985 as they seldom have before—if ever. It was a ball, a celebration we'll savor and not forget any time soon. Unless of course 1986 turns out to be just as good or even better than last year! (Forgive me—I'm only dreaming because the new year is off to such a good start)."

VI. INSURANCE INDUSTRY ACCOUNTING METHODS

In a March, 1985 report entitled "Congress Should Consider Changing Federal Taxation of the Property/Casualty Insurance Industry," the General Accounting Office found that three special property/casualty insurance industry accounting conventions enable the industry to dramatically understate its taxable income. As a result of these conventions, the industry has net gains but pays no tax year after year. *See* October, 1985 GAO report cited in Note 1.[7]

The most important of these conventions—the loss reserve deduction—permits property/casualty companies to take a deduction in the tax year both for the amount they pay out in claims in the tax year and the amount they estimate they will pay out in claims in the future. This amount is often wildly overestimated; moreover, the insurance company invests and earns income on the amount it estimates it will pay out in the future, and neither the amount deducted nor the investment income earned thereon is ever taxed. When the property/casualty industry says it had an underwriting loss in 1985, therefore, that does not mean that it paid out in 1985 more than it took in in 1985; rather, it means that it claims it will eventually pay out—over, say, the next eight or ten years—more than it took in in 1985. Left out of the calculation is the investment income the industry earns over the next eight or ten years on what it takes in in 1985; the time value of money is ignored.

VII. OTHER FACTORS POSSIBLY CONTRIBUTING TO PREMIUM INCREASES AND REFUSALS TO DEAL

While the available data demonstrate that limiting compensation for severely injured people—which regrettably some have suggested—does not bring down insurance rates,[8] making our legal system more efficient might well have such an effect. Exhibit F is a list of 10 legal reforms which NICO believes could make the legal system more efficient and could contribute to lowering insurance rates.

Similarly, better risk management by businesses and better self-discipline by professionals could reduce the incidence of claims and thus lower insurance rates.[9]

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[7] The members of this Committee who also sit on the Finance Committee may want to examine the non-taxation of the property/casualty industry in considering tax reform this year.

[8] *See, e.g.*, Sloan, "State Responses to the Malpractice Crisis of the 1970's: An Empirical Assessment," 9 Journal of Health Politics, Policy and Law 629 (Winter, 1985) ("The empirical results of the study presented here give no indication that individual state legislative action, or action taken collectively, had their intended effect on premiums.") *See also* Exhibit E (refusals to deal prevalent in Canada despite restrictive tort law).

[9] *See, e.g.*, Public Citizen's Health Research Group, "Medical Malpractice: The Need for Disciplinary Reform, Not Tort Reform," August 27, 1985, and studies therein cited (unanimously concluding that doctor discipline is inadequate).

VIII. CONCLUSION

The American legal system has received extensive scrutiny by state and federal legislators, the press and the public during the past several years. Doctors, lawyers and other professionals who are negligent, and manufacturers who make defective products, have also received substantial scrutiny in recent years.

The insurance industry, on the other hand, has received virtually no scrutiny by legislators, the press or the public. This Committee is to be congratulated on beginning an examination of the conditions in and practices of the property/casualty insurance industry. NICO urges this Committee to carefully analyze the contribution of insurers, insureds and the legal system to periodic refusals to deal and sharp premium increases in the insurance industry and to develop legislation that will prevent such increases and refusals, now and in the future.

The CHAIRMAN. Ms. Walters, thank you very much.

Ms. WALTERS. Thank you, Mr. Danforth.

I am senior vice president of Insurance Services Office. I am a fellow of the Casualty Actuarial Society and a member of the American Academy of Actuaries.

Insurance Service Office is a not-for-profit corporation that makes available rating, statistical, actuarial, policy form, and related services to any U.S. property/casualty insurer. We are not a trade association, though, and we do not lobby.

During the past year, the availability of property/casualty insurance has come to the forefront as a major public issue.

Insurers have found the need to dramatically raise prices and, in some instances, to recognize that certain classes of business may simply be uninsurable. During these difficult times, rather substantial differences have emerged between the property/casualty insurance business and some critics over the true financial condition of the industry.

In order to separate fact from fiction, and permit an objective determination of the current financial state of this industry, Insurance Services Office is now completing a document which presents a broad and thorough perspective of the property/casualty industry's financial condition.

It also refutes the critics charges point by point, many of the very charges we have heard here today, and some you yourself, Mr. Chairman, have alluded to. Printed copies of this document we hope will be available within the next 2 weeks, and I would be very pleased to submit a copy for the record of this hearing.

I would like to just very briefly summarize a few points from that report. I apologize in advance if there is any redundancy with Mr. Beer's testimony. There may be slight redundancy. It is beyond dispute that 1984 was the worst year to date for the property/casualty insurance industry. The industrywide return on net worth was below 2 percent, with total earnings for the entire industry of only $1.3 billion.

By means of comparison, the rate of return for the Fortune 500 in 1984 was 13.6 percent. I am sorry Mr. Hollings is not here, because in 1984 many insurers actually lost money overall. In fact, 330 insurer groups representing 40 percent of the total industry premiums recorded negative returns on net worth in 1984.

The most important component of insurers net income after taxes is operating income. That is, the sum of underwriting income and investment income. Underwriting income, as has been explained, is simply the difference between premiums earned and the sum of claims, expenses, and policyholder dividends.

That underwriting income has actually been a loss beginning in 1979 for every year beginning in 1979. Each subsequent year brought an evergrowing underwriting loss reaching a staggering $21.7 billion in 1984. In all but 2 years of its history, the industry's investment income was sufficient to offset those underwriting losses. The first time investment income did not exceed underwriting losses was in 1975 when it fell short by $300 million. In 1984, a new record was set with underwriting losses exceeding investment income by $4 billion.

Only unusually large capital gains and tax credits permitted the industry's bottom line earnings to be positive at all. But these sources of income are not predictable or regularly recurring, and certainly cannot be depended upon to provide additional similar amounts of income in future years. If this industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income. But positive operating income, the difference between underwriting and investment income, has been very hard to achieve.

In fact, all available evidence indicates a record operating loss for 1985, despite the substantial premium increases. And it is highly unlikely that the full-year 1985 return on net worth will exceed 4 percent. Again, we are looking at Fortune 500 returns in the 13-percent range.

Insurers that concentrate in commercial lines, which is where all the problems are being experienced today, have experienced an even more dramatic drop in earnings with a negative 3-percent return on net worth in 1984. Some critics have alleged that these recent years have just reflected a typical cyclical period. I think the evidence thus far presented and in my formal testimony makes clear that it has been anything but a typical cycle.

Some critics have charged the premium increases currently are too high and there is no extraordinary or unusual growth in losses to justify those increases. That charge is incorrect. Certainly we cannot deny that insurers reduced prices far below the level needed to cut the loss costs, but the growth in property/casualty losses has exceeded the country's economic growth in the past 5 years. During 1979 to 1984, paid losses—paid losses—overall grew by 76 percent, or 3.4 points per year faster than GNP. And commercial liability paid losses increased 130 percent during the period well over double the GNP growth rate.

These large premium increases, particularly for the commercial liability lines, will not recoup past losses or make up for substandard returns. They are simply needed to bring insurance prices today up to the level of loss costs which are expected to be incurred under today's insurance policies. A full and thorough discussion of these points and many others is in my formal testimony, and even greater discussion will be in the document I referred to earlier which we would be pleased to submit for the record.

The CHAIRMAN. Thank you, Ms. Walters.

[The statement follows:]

STATEMENT OF MAVIS A. WALTERS, SENIOR VICE PRESIDENT, INSURANCE SERVICES OFFICE, INC.

I am Mavis A. Walters, Senior Vice President of Insurance Services Office, Inc. I am a Fellow of the Casualty Actuarial Society (CAS) and a member of the American Academy of Actuaries, and currently serve as an elected member of the Board of Directors of the CAS.

Insurance Services Office, Inc. (ISO) is a non-profit corporation that makes available rating, statistical, actuarial, policy form and related services to any U.S. property/casualty insurer. ISO provides advisory research services to more than 1300 property/casualty insurance companies in the U.S. ISO is not a trade association and therefore does not engage in lobbying on behalf of insurers.

ISO has no mandatory membership requirements, nor do we have adherence requirements with respect to advisory rates, loss costs, policy forms or programs. In fact, we actively encourage independent action by participating insurance companies. ISO is committed to providing the information tools that will help its participating insurers serve the insurance-buying public.

We serve participating insurers by gathering, storing, and disseminating statistical information to regulators, as required by law, and to insurers for their own use. We also develop and assist in implementing programs that help define and cover risk. We promulgate advisory rates or advisory prospective loss costs for sixteen lines of insurance including personal lines (automobile and homeowners) and commercial lines of insurance such as Commercial General Liability (CGL).

During the past year, the availability of property/casualty insurance has come to the forefront as a major public issue. Insurers have found the need to dramatically raise prices and in some instances recognize that certain classes of business may simply be uninsurable. During these difficult times rather substantial differences have emerged between the property/casualty insurance business and some critics over the true financial condition of the industry. In order to separate fact from fiction and permit an objective determination of the current financial state of the industry, Insurance Services Office is now completing a document which presents a broad and thorough perspective of the property/casualty industry's financial condition; it also refutes the critics charges point by point. Printed copies should be available by the end of next week and a copy will be submitted for the record of this hearing.

This testimony presents a summary of the more important sections of that report.

It is beyond dispute that 1984 was the worst year to date for the property/casualty insurance industry. The industrywide return on net worth was below 2% with total earnings of only $1.3 billion. The Fortune 500 companies' median return was 13.6% in 1984, averaging 13.2% over the last 10 years, and has never fallen below 10% during that time. During the 1980's the return on net worth for the property/casualty industry has moved increasingly below the average rate for the Fortune 500.

Many insurers actually lost money overall. Three hundred thirty insurer groups representing 40% of total industry premiums recorded negative returns on net worth in 1984. Eighty-four insurers lost more than one-quarter of their surplus during that year.

The most important component of insurers' net income after taxes is operating income—the sum of underwriting income and investment income. Underwriting income (the difference between premiums earned and the sum of claims, expenses, and policyholder dividends) has actually been an underwriting *loss* beginning in 1979. Each subsequent year brought ever-growing underwriting losses—reaching a staggering $21.7 billion in 1984.

In all but two years of its history, the industry's investment income (the interest and dividends received on investments) was enough to offset underwriting losses. The first time investment income did not exceed underwriting losses was in 1975, when investment income fell short of the underwriting deficit by $300 million. In 1984, a new record was set, with underwriting losses exceeding investment income by $4.1 billion. Only unusually large capital gains and tax credits allowed the industry's bottom-line earnings to be positive in 1984. However, these sources of income are not predictable or regularly recurring and therefore cannot be depended on to provide similar amounts of additional income in future years.

Until very recently, capital gains realized by the property/casualty industry were relatively insignificant compared to net worth. From 1975 to 1982, total realized capital gains never exceeded 1% of net worth, but in 1983, the ratio grew to 3% and continued upward in 1984 to 4%. In addition, during the last 2 years substantial tax credits were available to property/casualty insurers that incurred a pre-tax loss for the year, if they paid taxes during a prior taxable period. Substantial tax credits cannot be expected to continue.

In 1984 the property/casualty insurance industry benefited from nearly $5 billion of realized capital gains and tax credits. However, over the prior twenty years the average of total capital gains and federal income taxes was a net of only $500 million a year. Given their historically small contribution to total profit, realized capital gains and taxes cannot be relied upon to provide a continuing and consistent bailout for operating losses. If the industry is to maintain a reasonable level of profitability for the long term, profits must come from operating income.

Positive operating income—the difference between underwriting loss (after policyholder dividends) and investment income—has been hard to achieve. Although investment income has grown steadily over the last decade to $18 billion in 1984, its average annual increase since 1980 has been less than $2 billion, while underwriting losses increased at an average annual rate of over $4 billion. All available evidence indicates a record operating loss for 1985, despite substantial premium increases. If operating income is to become a source of profits, underwriting losses must be drastically reduced from the 1984 level of almost $22 billion. For this to happen, premium increases would have to continue to exceed the rate of growth in claim costs.

Actual year-end 1985 results for the property/casualty industry will not be compiled until late March or early April. However, figures for the first nine months of 1985 show only slight improvement over the comparable period in 1984. It is highly unlikely that the full year 1985 return on net worth will exceed 4%.

The underwriting loss of 1985 is expected to exceed the 1984 record of $21.7 billion. During the first 9 months of 1985 the industry recorded an underwriting loss of $17.8 billion, compared with a loss of $15.2 billion for the first 9 months of 1985.

During the first 9 months of 1985, investment income fell short of the underwriting loss by $3.4 billion, compared with the shortfall of $2.5 billion for the first 9 months of 1984. All available evidence indicates a record operating loss for 1985.

Financial results have varied widely among insurers. For example, since 1979, insurers that concentrated in the personal lines fared better than the remainder of the industry. While these personal lines insurers' profits dropped from 1979 to 1984, their decline has been more moderate than that of the entire industry. The return on net worth for predominantly personal lines insurers fell from over 13% in 1979 to below 8% in 1984.

Insurers that concentrate in commercial lines have experienced a much more dramatic drop in earnings. In 1979, this group achieved a slightly higher return than personal lines insurers, posting a 15% return on net worth. The return declined steadily during the early 1980's, reaching a negative 3% return on net worth in 1984.

Reinsurers, who have grown to be an important segment of the industry, and who have provided a crucial link in the availability of insurance coverage have had disastrous results recently. Their recent returns have been considerably worse than the industry average.

From 1979 through 1983, U.S. reinsurers' returns on net worth were comparable to those of the entire industry. In 1984, reinsurers' returns plummeted to a negative 10%, nearly twelve points below the industry average. This result was a significant factor in the insurance marketplace disruptions that occurred in 1985. Many reinsurers withdrew partially or totally from writing business; others restructured coverages (adding exclusions or restrictions) and increased prices in an attempt to return to profitability.

A TYPICAL CYCLE?

Some critics have alleged that the recent years have reflected nothing more than a typical cyclical period for property/casualty insurers. The fact is that this has been anything but a "typical" cycle. Underwriting losses, operating losses, combined ratios, the number of insolvencies, and the number of companies targeted for immediate regulatory attention were all at record highs in 1984, while the industrywide return on net worth was at an all time low. And reinsurers, on whom the insurers depend as never before, have been seriously weakened.

The 1984 underwriting loss was $21.7 billion. Prior to this cycle, the record underwriting loss was $4.2 billion in 1975. The 1984 operating loss was $4.1 billion. The previous record was $0.3 billion in 1975. On the basis of bottom line results, the 1984 return on net worth was 1.7%, despite a record $4.8 billion of realized capital gains and tax credits. The previous low return on net worth of 2.4% occurred in 1975 when the sum of tax credits and realized capital gains was only $0.7 billion. Even the extraordinary amount of realized capital gains and tax credits in 1984 did not compensate sufficiently for the huge operating losses to produce a return on net worth equal to the 1975 level. The 1984 combined ratio was 118.0. Prior to this cycle, the record was 107.9, again, in 1975.

In 1969, the National Committee on Insurance Guaranty Funds began to collect data on insolvencies that trigger state guaranty funds. Until last year, the record number of insolvencies in any two year period was 25. During 1984-85 there were 40 insolvencies and the books are not yet closed.

The National Association of Insurance Commissioners (NAIC) developed an early warning system to alert regulators to potential insolvencies. In discussing the 1985 test results, Iowa Insurance Commissioner Bruce W. Foudree, former President of the NAIC, said the 215 property/casualty insurers have been targeted as in need of immediate regulatory attention under the NAIC early warning system, "the most ever and a 73% increase over last year".

One of the most important differences between this down cycle and all previous ones is its length. This time, the combined ratio worsened for seven consecutive years beginning in 1978. Previously, the longest continuous period of deteriorating combined ratios was for the five years 1960 through 1964. During that period, however, the combined ratio worsened by only five points; in this cycle it deteriorated by 21 points.

Another indicator of the depth of this cycle is the number of insurers receiving a reduction in any year from the A.M. Best rating of A+. That number increased from 23 in 1982, to 61 in 1983, to 80 in 1984 and finally to 149 in 1985. In 1985 only 24% of the companies rated received an A+ compared with an average of 39% in 1976 and 1977 following the last adverse underwriting cycle.

The property/casualty industry is now more dependent on the reinsurance mechanism than ever before. During 1979-1984, reinsurance recoverable (monies owed to insurers by their reinsurers) more than doubled, while premiums and surplus grew by 30% and 50%, respectively. For reinsurers themselves, the amount more than tripled during this period while their premium and surplus grew by 54% and 73%, respectively. At the same time as dependence on reinsurance rapidly increased, reinsurers' financial condition seriously eroded. The 1984 return on net worth for the entire insurance industry was nearly 2%, while it was −10% for reinsurers. In 1985, A.M. Best lowered the ratings of half the reinsurers rated.

For the past two decades, reinsurers' combined ratios have closely paralleled those of the property/casualty industry with the gap never exceeding 4½ points, except for the 6-point gap in 1965, the year of Hurricane Betsy. As recently as 1982, the two combined ratios were only 1/10 of a point apart. The gap grew to 6 points in 1983 and then to 13 points in 1984. Although this gap began to narrow in 1985, reinsurer combined ratios are still substantially worse than those of the entire property/casualty industry.

Historically, personal and commercial lines results have been similar. Between 1967 and 1982, the difference between the combined ratios never exceeded 6 points. As recently as 1981, the ratios were only 2 points apart. Then in 1983, the gap grew to 12.5 points. In 1984, when it grew to over 20 points, those insurers writing predominantly commercial lines had a negative return on net worth. In 1985, the gap began narrowing but still stood at nearly 15 points for the year ended September, 1985.

An even greater concern for commercial lines insurers and reinsurers is that their combined ratios are understated due to reserve inadequacy. Because of this, the combined ratios for these insurers are undoubtedly even worse than the record highs recorded.

Richard E. Stewart, former Superintendent of Insurance of the State of New York, discusses the current cycle in a December, 1985 Marsh & McLennan Commentary article. In it, he writes: "this is not just a routine turn in the underwriting cycle. It has structural as well as cyclical causes." He further notes, "Whereas economic inflation drove the casualty insurance crisis of the mid-seventies, the current one is driven by terrible events and by changes in liability law". And he adds: "Insurance has met liability problems before. These are liability disasters. No exclusion is reliable, no excess level out of reach."

All these elements strongly support the conclusion that this is not just a "typical cycle" for the property/casualty insurance industry. Because reinsurers and commercial lines insurers have been hit harder, premium increases will fall unevenly, with some policyholders experiencing very large increases. Because the industry's downturn lasted longer than ever before, the recovery must last longer as well. And, because the depth of the downturn was worse than ever before, a stronger recovery will be necessary.

A MANUFACTURED CRISIS?

Critics have charged that premium increases currently are too high and they result solely from insurers past inadequate prices. There is no extraordinary or unusual growth in losses to justify these increases so they claim.

Their charge is incorrect. Certainly, no one can deny that insurers reduced prices far below the level needed to cover loss costs. However, growth in property/casualty losses has far exceeded the country's economic growth in the past 5 years, as measured by GNP. Each year, losses have surpassed expectations and losses are now growing faster than any standard measure of economic growth.

During 1979-1984, GNP grew 50% while written premium increased only 34%, or 2.4 points per year slower than the average annual GNP growth rate. On the other hand, paid losses grey 76%, or 3.4 points per year faster than GNP. Moreover, the increase in losses was not uniform across all lines of insurance. Commercial lines paid losses grew 92% while personal lines paid losses increased 62%, and commercial liability paid losses increased 130% during the period—well over double the GNP growth rate.

Finally, general liability and medical professional liability paid losses have grown 167% over the 5 year period—more than triple GNP growth. In fact, the increase in paid losses for these two lines has accelerated in recent years. From 1974 to 1979, paid losses for general liability and medical malpractice grew at a rate of 15% per year—about 4 points faster than GNP. But from 1979 to 1984, paid loss growth accelerated to a rate of 22% a year—13 points faster than GNP. If "social inflation" is measured as the difference between liability loss growth and GNP growth, then "social inflation" tripled from the 5-year period 1974-1979 to the next 5-year period 1979-1984.

While current availability and affordability problems are certainly due in part to past price reductions a major contributor to the problems has been the significant increase in losses. From 1979 to 1984 policyholders had the benefit of low insurance price levels that did not keep pace with losses. But, as a result, the insurance industry endured below average returns on net worth every year since 1979.

The large premium increases occurring now, particularly for the commercial liability lines, will not recoup past losses or make up for recent substandard returns. Such increases are needed simply to bring insurance prices up to the level of today's loss costs.

LOSS PAYMENTS OVERSTATED?

Critics have charged that insurance industry financial figures are misleading and distorted since their incurred losses contain estimates of future loss payments which are often overstated. The industry manufactured the last medical malpractice "crisis" by overreserving and has done the same thing this time, so the critics allege.

Not only does this charge have no basis in fact but it also contradicts the consensus opinion of recognized financial analysts, who believe that current loss reserves are understated. A published ISO study concluded that year-end 1982 industrywide loss reserves were deficient by more than 10%. Subsequent ISO analyses indicate that no significant strengthening occurred in industry loss reserves through year-end 1984. Furthermore, time has shown that, at the time of the last crisis in 1976, industry loss reserves were seriously understated.

It is true that loss reserves are estimates, made by insurers on a given date, of what additional loss payments will ultimately be made for a particular set of claims.

State insurance commissioners, charged with overseeing the solvency of insurers, suggest that loss reserves for most lines of insurance be reported at their full ultimate value. Reserves are particularly significant for the liability lines, for which the final payout may not be known for many years, which is why they are known as "long-tail" lines.

At the time of the last crisis—1976—the reserves set aside at year-end 1976, for all claims incurred to that date were $47.1 billion. As of year-end 1984, $48.6 billion had been paid out on those initial pre-1977 claim reserves. And an additional $8.0 billion was still held in reserve for the same group of claims—for a total payment of $56.6 billion rather than the $47.1 billion originally expected. The nearly $10 billion difference represents an initial reserve deficiency of 20%.

One reason that reserves set in the past for long-tail lines such as general liability have proven to be deficient is that scientific, technological, and societal changes have revealed new sources of exposure to injury and new theories of legal liability. For example, when general liability losses were reserved 10 to 20 or more years ago, insurers could not have predicted the huge number of claims related to asbestos, Agent Orange, DES, and other alleged causes of latent injuries under policies already written. At that time, no reserves were set up for future payments of those losses. It is now clear that the initial reserves established for those general liability policies will prove to be significantly understated.

This pattern of underreserving can easily be seen in two particularly long-tailed lines, general liability and medical malpractice. In 1976, general liability claim payments already made, plus the reserves carried for future payments on policies written through that year, totalled $24.0 billion. At year-end 1984, the estimated costs for those same general liability claims had risen to $28.0 billion, of which $26.0 billion had already been paid. This means that, as of year-end 1984, the original 1976 reserve was already insufficient by $4 billion.

For medical malpractice, the estimate for ultimate claim payments on the policies written through 1976 initially totalled $1.9 billion. The year-end 1984 estimate for those same medical malpractice losses had risen to $2.3 billion, of which $1.9 billion had already been paid. This means that, as of year-end 1984, the original 1976 reserve was already insufficient by $400 million.

The 1976 loss reserves were not unique. More recent years show a similar pattern of final losses which are likely to exceed the initial reserves. For example, the 1979 reserve for liability lines was $65.3 billion at year-end 1979. As of year-end 1984, $53.8 billion of those reserves had been paid and $15.7 billion was still held in reserve, for a total of $69.5 billion—an initial reserve deficiency of more than $4 billion (6%) as of year-end 1984. Given recent historical trends, it is likely that estimated final claim payments—and therefore, the reserve deficiencies—will grow as later evaluations are made.

A fuller discussion of these points and others, as well as explanatory charts, graphs and exhibits will be included in the ISO document now being completed. The printed document will be submitted for the record as soon as it becomes available.

The CHAIRMAN. Why is it, a lot of people have said that the stocks of insurance companies are going up? Why would that be, if they are in such bad shape?

Ms. WALTERS. I believe Mr. Beer commented on this slightly. I would like to elaborate a little bit. Stock prices reflect primarily investor expectations. It is certainly not surprising that investors are expecting insurer profitability to improve. It could hardly be otherwise. With a 1.7-percent return on net worth in 1984, and with signs that insurers have finally gotten control of their financial destiny by no longer cutting prices, but by firming prices and taking price increases, the signs are very clear for the sophisticated institutional investors that this industry is doing something to improve its position.

So, of course Wall Street expects profitability to improve. It is quite another thing, though, to conclude from that that profits today are high or in anyway excessive. In fact, I might add that when one reviews history and looks at the trend in insurance stock prices and compares that with the cyclical profitability of insurers, it becomes quite clear that Wall Street has not been too accurate in terms of predicting insurers overall profitability. By that, I mean very simply at the time of the last increase in profitability before this recent downturn in the late 1970's, stock prices were essentially flat. But yet when profitability turned in 1979 and continuing through 1984 and 1985, the most distressing and dismal downturn in the history of our business, stock prices throughout that entire period of time have continued to increase, despite record negative returns.

So, clearly Wall Street has not been a great predictor. But the essence is, they are expecting better returns, and I think all of us are hoping for better returns.

The CHAIRMAN. The preceding witness, Mr. Angoff, said that he thought we needed more information particularly relating to the claims that have been paid State by State. And Senator Pressler was particularly interested in getting more information from Mr. Beer.

Could your organization provide the committee with data on claims paid?

Ms. WALTERS. Certainly. In fact, I do not know if we have provided this committee with claims information, premiums, incurred losses, number of claims and loss ratios, but we have provided it to others, and we will continue to do so.

If I might be permitted, Mr. Chairman, I would like to make a statement on this whole subject of insurance data. I too have been in the insurance business for quite a few years now, and it is my observation that there is no other industry that operates in this country that makes available more data and more statistics in more different forms to more different authorities than does the insurance business.

We file annual statements—or insurers file annual statements with insurance departments, essentially financial information to provide the regulators with the information they need to perform their primary function, which is to monitor for solvency and solidity.

Insurers report statistical information to licensed statistical agents so that regulators and others can view the data to see whether or not the premiums and the rates by classification are right and proper. This industry provides rate filings to insurance departments to justify rate increases on a State-by-State, territory-by-territory, and class-by-class basis, and publicly held companies file data with the Securities and Exchange Commission.

So, there is an enormous amount of information available, and there is a lot more information available than I believe this committee may have been led to believe earlier. We have tremendous information in terms of countrywide loss experience, for municipalities, for day care center—and by the way, some of the information you heard was wrong there. The data we have for the day nursery class indicates that premiums have been insufficient to cover the losses, and the premium increases are well justified.

So, we would be pleased to make all of this information available.[1]

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[1] The publication, Insurer Profitability—The facts, was received and retained in the committee files.

The **Chairman**. That would be very much appreciated.

Also, if there is anything that you could supply us linking the tort system with the—maybe that would be purely speculative, but any information you could give us on the degree to which changes in tort law, unpredictability in tort law have created the problem.

Ms. **Walters**. You have certainly asked the $64 million question. I am not sure that there is any definitive way to quantify to everyone's satisfaction how much of the tremendous growth in losses is attributed to tort reform vis-a-vis anything else. But I believe that you will see in the document that I mentioned that we are preparing a very clear definition of what has been the absolute growth in paid losses for different lines of insurance in the most recent period of time.

Different people may have different reasons to conclude why it has grown so dramatically. I am not sure there is any definitive way to say it is one thing versus another, but it is clearly something very unusual that has not occurred in the prior 5-year period, or the 5 or 10 years before that.

The **Chairman**. Ms. Walters, thank you very much for your testimony.

Ms. **Walters**. Thank you, Mr. Chairman.

The **Chairman**. The next panel is Mr. Edmond Rondepierre, senior vice president and general counsel of the General Reinsurance Corp.; Mr. Andre Maisonpierre, Reinsurance Association of America.

Is there some antitrust conspiracy between your names?

STATEMENTS OF EDMOND F. RONDEPIERRE, SENIOR VICE PRESIDENT AND GENERAL COUNSEL, GENERAL REINSURANCE CORP.; AND ANDRE MAISONPIERRE, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA, ACCOMPANIED BY T. PARRINGTON SEMPLE, RESIDENT COUNSEL AND SECRETARY, AMERICAN REINSURANCE CORP.

Mr. **Rondepierre**. We have been getting away with it for 30 years now. We have been getting each other's mail every once in awhile too.

The **Chairman**. Mr. Rondepierre, would you like to go first?

Mr. **Rondepierre**. Thank you, Senator.

We did submit a statement for the record, and I would like to just briefly hit some of the high spots. General Reinsurance Corp. is by a wide margin the largest reinsurer domiciled in the United States. We are probably the third largest reinsurer in the world. And perhaps contrary to an impression you may have been given earlier today, our estimate is that about 25 percent of the reinsurance purchased by American companies is in fact purchased outside the United States; 75 percent of it is purchased inside the United States.

The statement includes some data on the relative size of the market. I would like to summarize that by just saying that the domestic reinsurance market is probably less than one-tenth of the size of the domestic primary market in terms of surplus, and in fact its premium volume is about one-tenth of the premium volume of the primary market.

We frequently find in noninsurance forums that people perceive that the reinsurance industry is larger than the primary industry. The exact reverse is in fact the case.

I would like to skip through to my comment about the reason for the current shortage of availability of reinsurance. If I have to pick a single phrase, it would be the lack of predictability. You will find in our paper the comment that predictability influences both the absolute availability of reinsurance and indeed the price.

The question is not an absolute black-and-white determination. It is a question of the level of confidence that the underwriter has and his ability to predict future costs. We sell a contract the costs of which will not be absolutely known for 10 or 15 or perhaps 20 years in the future. In order to sell a contract like that, the underwriter has got to have some level of confidence that he can indeed predict costs that far in the future.

Because of the rapid change, and we think the rather erratic changes that have taken place in our civil liability system over the last 15 or 20 years, it is almost impossible for an underwriter looking at the experience acquired during that 15- or 20-year period to project and anticipate what his costs will be under that system 15 or 20 years from now.

Perhaps a recent experience in General Re will serve to illustrate. We had been a major reinsurer of medical malpractice insurance for a number of years, much of which was written on an occurrence form. Over the years, we saw some of the typical defenses erode; we saw standards of care imposed in determining liability which were in fact current day standards of care applied to procedures which had been performed 15 or 20 years earlier; and we saw a number of other rather radical changes in the way medical malpractice liability was established.

As those things happened, a great many of the insurers and reinsurers dropped out of that market. General Re continued. Because we were dealing with a business with a 20-year tail, we of course reevaluated the reserve necessary to ultimately pay those liabilities on a year-by-year basis. When we got to 1984, we found it necessary to increase those reserves, despite all of the prior adjustments, we found it necessary to increase those reserves by more than $100 million.

It became abundantly clear to General Re that we had been unable to make a reasonable estimate of what the ultimate costs of those coverages would be at the time they were sold, and the question facing us then was, in 1984, how confident are you that you can predict the costs of medical malpractice insurance in the year 2000?

We concluded, as you might imagine, that we had very little confidence in our ability to do that, and we discontinued writing the occurrence form of malpractice insurance. We do still reinsure medical malpractice on a claims-made form. We discontinued the occurrence form.

I am sure you will find that other underwriters have had similar experiences with other lines of insurance, and that the shift toward a claims-made form is an attempt to reinstall some kind of predictability under the system, or at least to shorten the period over which the underwriter is required to predict.

I would like to emphasize that when an underwriter does look at past experience in an effort to predict the future, he has to make adjustments for those changes that differentiate between the experience period he is examining and the current-day circumstances. If he is in a business where his contract is going to be evaluated 5, or 10, or 20 years in the future, he has now got to anticipate what will the civil liability system look like then?

And if he is unable to make a reasonable approximation of that value, he will either have to hedge his bet on how he establishes premiums, which tend to make premiums higher, or in the alternative if he is unwilling to take the gamble at all, he simply refuses to quote, and that brings about the availability crisis that we have.

Our own feeling is that there are identifiable items within the civil liability system which tend to aggrevate the predictability of civil liability. One of those is punitive damages. We find that the punitive damage system instills a profit motive for bringing litigation. We think it is a kind of a crapshoot to estimate what the amount of punitive damages will be, and we question very seriously whether it belongs on the civil side of the justice system.

We have a similar reservation with respect to joint and several liability. You have heard some other witnesses refer to that this morning. I think that is another area that deserves attention. If civil liability is to be reviewed, we should decide whether or not joint and several liability should be continued. We have similar feelings about the state-of-the-art defense. We have similar feelings about contributory negligence, assumption of risk, informed consent, and the other kinds of defenses to civil liability which have been eroded over the years.

An underwriter can live with a predictable increase in costs. If we were told that the civil liability system will increase in cost at a rate of 10 percent a year over 20 years, he could live with that. I am not so sure the public could pay those premiums, but the underwriter would be able to quote rates. In our present system, I think we are lacking sufficient predictability to make those kinds of quotes.

I would be happy to answer your questions.

[The statement follows:]

STATEMENT OF EDMOND F. RONDEPIERRE, SENIOR VICE PRESIDENT, GENERAL COUNSEL AND SECRETARY, GENERAL REINSURANCE CORP.

The Committee is seeking information about the availability—or lack of availability—of insurance and reinsurance to cover U.S. risks, and we are pleased to have the opportunity to present our views in this preliminary session and to provide further information as your inquiry continues.

General Reinsurance Corporation is the largest reinsurer domiciled in the United States and the third largest reinsurer in the world. Although General Re writes reinsurance virtually all over the world, the vast majority of its business is in the U.S. General Reinsurance Corporation writes business on a direct basis; its sister company North Star Reinsurance writes reinsurance produced by brokers.

We will address the question of availability from the perspective of the reinsurer. There is no question that there is a shortage of capacity for many kinds of insurance, and that the shortage of reinsurance capacity contributes to that problem.

I believe it is important to comment on the measure of capacity. While a number of different yardsticks could be used, I think the most useful one for our purposes would be the surplus of insurance companies and reinsurance companies engaged in this market. The surplus of the U.S. insurance industry is estimated to have been

$65.4 billion at year end 1983, $63,800,000 at year end 1984, and $71,000,000 at year end 1985. The 1985 figure includes about $5 billion in new capital from investors.

The surplus of the reinsurance market is much more difficult to estimate. A number of companies engaged in the reinsurance market are also engaged in the direct insurance market and it is difficult to segregate surplus; even more significant, approximately 25% of the reinsurance purchased by American insurers is provided by alien insurers whose accounting practices differ, and for whom a comparable "surplus" figure is unavailable. It is possible, however, to extrapolate from figures supplied by the Reinsurance Association of America. The companies reporting to that Association showed aggregate surplus of $4.5 billion at year end 1983, $4.2 billion at year end 1984, and $4.1 billion at September 30, 1985. We would assume that, however it is measured, the "surplus" of reinsurers not reporting through the RAA has been similarly effected.

One reason for this erosion in surplus has been the adverse loss experience of insurers and of reinsurers, during the past three years. The reinsurers reporting through the RAA experienced aggregate combined ratios in those three years of 111% for the year 1983, 128% for the year 1984, and 119% through September 30, 1985.

Even more dramatic than the erosion of surplus through underwriting loss is the withdrawal from the reinsurance market. We estimate that some 90 underwriters who were assuming reinsurance in 1984 had withdrawn partly or entirely from the market by year end 1985. Twenty of them through insolvency or other involuntary causes.

The overall result has been a significant reduction in absolute capacity in the reinsurance market.

During that same period of time, the demand for insurance, and for reinsurance, has increased substantially. The insurable values of properties at risk have increased and, perhaps more significant, the exposure to liability loss has increased.

Given a shortage of absolute capacity in the insurance and reinsurance industries, it is our perception that the available surplus will be employed where the underwriters can reasonably expect to make a reasonable return on equity. That expectation is a function of the predictability of loss and the ability to collect an adequate premium.

Reinsurance like insurance, requires pricing of the product before the costs are known. Reinsurance underwriters like insurance underwriters make estimates and predictions about losses which they would expect to be called upon to pay in the future on the basis of contracts issued in the present. It follows that, the capacity shortage will be most serious where underwriters collectively are not confident of their ability to reasonably estimate the prospective costs of affording coverage.

It is easy for anyone not making the commitment to criticize those who are making the commitment. However I think it should be emphasized that the underwriter lives in the real world. He doesn't require proof that he will make a profit in order to assume a liability; conversely, he is not required to prove he would lose money in order to decline the liability. He is required—by his company's owners, and by the regulators—to exercise his best judgment in underwriting risks reasonably expected to produce a fair return.

To the purchaser of reinsurance—and insurance—the availability problem appears both in terms of absolute capacity, and in terms of price. I have indicated that absolute availability is a function of predictability, and so is price. Predictability, from the underwriters point of view is not a black and white issue; it involves a level of confidence in the predictability of a given line of insurance, policy form, type of exposure, etc. Where the underwriter has a high level of confidence he will be quite aggressive in competing for business at that rate which he believes will produce a fair return. As his level of confidence in the prediction diminishes he will tend to hedge his bet by making greater allowance for contingencies and therefore creating higher rates. When his level of confidence gets to the point that he is unable to develop a rate, he declines to quote.

A recent experience in General Re will serve to illustrate. General Re has been for years a major reinsurer of medical malpractice exposures. Much of the business was written on an "occurrence" form. That means that liability arising out of a procedure performed today may in fact be asserted 10 or 15 or 20 years in the future. Over a period of years, it developed that the standards by which liability would be judged, the effectiveness of defenses available to doctors, the measure of damages, would all change substantially after the time the policy was written and before the time the claim was asserted. It became increasingly difficult for underwriters to make a reasonable judgment, at the time the policy was written, as to the ultimate costs of claims 10 or 20 years in the future, and many underwriters withdrew from the medical malpractice line.

General Re continued to provide a market for medical malpractice reinsurance on an occurrence basis for some time after most participants had withdrawn. With a loss development period of more than 20 years, the company of course revised its estimate from year to year on the basis of the best information then available.

In 1984, General Re found it necessary to increase its reserve for medical malpractice occurrence claims by more than $100,000,000. It became abundantly clear that we had in fact been unable, at the time those contracts were written, to make a reasonably accurate estimate of the cost. It was equally apparent that we were unable in 1984 to predict the costs of medical malpractice coverage in the year 2000, and we discontinued offering the occurrence form.

We did and do continue to reinsure medical malpractice, but on the claims made form. The reason for the change—the availability crisis if you choose—is the inability to predict with reasonable confidence the future costs—beyond 5 or 8 years—of medical malpractice liability.

Obviously, other underwriters are having similar experiences in other lines of insurance and, have either withdrawn from those markets, or have shifted to the claims made form in order to be able to maintain a market.

If my premise is correct that the level of predictability and the availability of adequate premiums will determine availability, then an attempt to solve the availability problem should examine those two features.

One of the principal tools used by underwriters to predict prospective losses is an analysis of past experience, and the identification and projection of trends. Of course, to the extent that present day circumstances differ from the circumstances during which the experience was developed, the statistical analyses and trends would have to be modified. Similarly, since we are pricing for a determination of liability in the future—many years in the future—the underwriter must make allowances not only for the change in circumstances from the historical statistical period to the present, but he must also anticipate changing circumstances years into the future.

In our American civil liability system, it is obvious that many of the changes which have evolved over the past 10 or 15 years could not have been anticipated, and it is equally apparent that this evolution has not come to an end. It should be fairly easy to understand then, that the underwriter does not have a great deal of confidence in his ability to predict the costs of providing a legal liability coverage as those costs may be ascertained 10 years or 15 years in the future.

It is not the purpose of this presentation to discuss the reasons for the evolution in our civil liability system, and I will simply state as a conclusion that we have experienced novel theories of liability, we have witnessed the erosion of traditional defenses, we have seen the imposition of present day standards of care in the determination of liability for conduct which took place many years ago, and we have experienced novel interpretations—indeed reconstruction—of contracts under theories unthought of at the time the contracts were drafted.

Superimposed over these factors is an escalation in the measure of damages, and an escalation of the instances in which punitive damages may be awarded.

These evolutions—with the exception of punitive damages, do increase the benefits to the plaintiffs and, I assume it is recognized, do inevitably increase the costs to the insuring public. I think what may not be fully perceived is that just as they present the underwriter with unanticipated losses, they also reduce his confidence in his prediction of future costs and therefore directly create an availability problem.

As for punitive damages, they do not represent compensation to the particular plaintiff. They are a form of retribution and punishment and, in my opinion, should be regarded as a windfall to the individual plaintiff, and a bounty hunter type incentive to the plaintiff's lawyer. We may conclude that, as a matter of public policy, these are circumstances in which a bounty hunter approach is justified however, when we do that, we should recognize that we will have to pay the costs.

Even where punitive damages are not insured, they directly impact insurance costs. The availability of punitive damages—or the threat—affects the willingness—or the ability—of the defendant to resist a claim, and it affects the settlement value of every claim.

The rapid evolution of our civil liability system, the abandonment of precedents, and the establishment of new theories of liability have other repercussions as well. It is certainly much more difficult for a lawyer to counsel his client who asks "what must I do to avoid liability". On the other side, it is increasingly difficult for a plaintiff's lawyer to advise his client that he has no legal remedy. The perception of our system, by some, would lead a plaintiff's lawyer to say "if there is any chance that this case might establish a new theory of liability, or reverse a precedent, don't I have an obligation to try it". This atmosphere has greatly increased the costs of investigation and defense, adding another element to the current costs, and further contributing to non-predictability.

Insurers can't change the civil liability system. They also can't help focusing public attention on the costs of the system since they are most often the vehicle through which those costs are communicated to the public.

In the context of these hearings, my point is that those developments in our civil liability system contribute not only to the current costs of insurance, but also to the limited availability or non-availability of reinsurance in many areas.

I started my remarks by illustrating that there is a shortage of absolute capacity. I'd like to address the question whether that absolute capacity can be increased.

As an introduction to this topic I should say that entry into the reinsurance field is extremely easy. Just as there have been a substantial number of withdrawals of reinsurers from the market, there can easily be a substantial number of returns or new entries.

With respect to those companies remaining in the market, it is evident that the capital markets will still support a sound reinsurance operation. General Re has completed two stock issues in the last eight months, bringing in $600,000,000 in new capital.

The third major method for increasing capacity—and it affects the other two—is retained earnings from underwriting operations. Just as underwriting losses have eroded surplus, underwriting gains will serve to increase surplus and capacity. The reasonable prospect of those earnings will attract capital infusions to existing reinsurers, new entries to the reinsurance market, and possibly the return to the market of some of those reinsurers whose withdrawal was voluntary.

In recent months we have, in a number of instances, heard the argument that insurance is not available because reinsurance is not available. That is certainly true in some instances. In the case of those reinsurers who have withdrawn from the market or who became insolvent, their former client companies will find it difficult if not impossible to replace that reinsurance and, without reinsurance, may find it difficult to renew business or to accept new risks. In a number of other cases, reinsurers may have found it impossible to continue to reinsure a particular line of business or a particular form of coverage, and their decision to withdraw may precipitate a decision by the primary company to reduce limits, or to discontinue the coverage.

In order to determine whether that trend is reversible, it is necessary to look at the function performed by reinsurance or, more to the point, functions which are not performed by reinsurance.

Reinsurance cannot cure a rate deficiency. The rates and premiums established by the primary insurance company determine the total amount of premium available for the insurance of the risks. A reinsurance agreement divides the risk, and the premium, between the two insurers who are parties to the agreement. If the premium charged for the primary insurance was not sufficient to cover all of the risk, the insurer and the reinsurer will in all likelihood not be able to arrive at an equitable division of that premium and the primary company will find it difficult or impossible to buy reinsurance. The only solution for that problem is to charge an adequate premium at the primary level. Where regulations preclude the primary company from charging an adequate premium they create an availability problem.

Reinsurance also cannot resolve unpredictability. One of the functions of reinsurance is to make the net risk retained by the ceding company more predictable for the ceding company. This is accomplished by reinsuring that part of any loss which exceeds a stated amount. Having thus eliminated the possibility of any individual loss exceding his predicted maximums, the net risk to the ceding company is more predictable. The reinsurer, of course, is the obverse side of that coin. In order to be able to quote a price for excess reinsurance, the reinsurer must have sufficient confidence in his ability to predict the frequency and the severity of losses which will exceed the retention amount.

In summary, the solution to the availability of reinsurance depends on two factors; 1) prices which are responsive to the changing costs of providing coverage 2) the restoration of sufficient predictability to enable underwriters to price prospective liabilities.

At the present time, we are being told that neither of those goals is attainable. For many risks, a price which fairly represents the costs of covering the legal liability exposure is an unaffordable price. That is not a fault of the insurance or reinsurance system, and the remedy must lie in cost containment within the legal liability and reparations system.

Predictability can, to a degree, be improved by the insurance industry by amending its forms of coverage. The claims made form is an industry effort to improve predictability. What is needed to further improve predictability, or to make the occurrence form of insurance predictable, is a stabilization of the civil liability system to the extent that recent historical experience can be relied upon to estimate prospective costs.

Capital markets have demonstrated confidence in the insurance and reinsurance mechanisms and there will be ample capacity wherever there is reasonable expectation of a fair return on invested capital.

[The following information was subsequently received for the record:]

General Reinsurance Corp.,
Financial Centre,
Stamford, CT, March 31, 1986.

Senator John C. Danforth,
Senate, Committee on Commerce, Science, and Transportation, Washington, DC.

Dear Senator Danforth: I was pleased to have the opportunity to address your Committee on the subject of availability and costs of liability insurance. I'd also like to express my appreciation for the way in which John Hall handled the structuring and scheduling of the hearing.

Senator Pressler has raised some very cogent questions, and my answers, in the order in which he presented the questions, are as follows:

1. Reinsurers, collectively, suffered even greater losses in 1984 than did the primary insurance industry. The losses were not evenly spread among reinsurers. In our view, many of the new entrants into the reinsurance market, charged rates and granted contract terms which we regarded as irresponsible. During that time, General Re reported to its stockholders that we would not engage in that kind of irresponsible competition, and that the stockholders should be prepared to see minimal premium growth in General Re, and possible loss of market share. Our explanation to the stockholders was that such low prices and generous terms would severely damage the "naive capacity" which was offering those terms and rates. We explained that when that happens there will be a rash of insolvencies, withdrawals, cutbacks, price increases, etc., and the strategy of General Re was to keep its surplus intact so as to be in a position to respond to the increased demand for reinsurance which would result. In our view, this readjustment began in late 1983, and accelerated in the first half of 1984. As with all such market adjustments, as "naive capacity" becomes more suspect, and reassessments are made, the pace of the correction accelerates exponentially. By the third quarter of 1984 there was what some observers call a "turnaround" in the market, and what General Re described to its shareholders as a "flight to quality". Clearly, some of the new entrants had failed, or withdrawn, or cut back severely, and their results are reflected in the reinsurance industry averages. Although General Re's policy was to avoid engaging in that kind of competition, we nevertheless suffered our worse year in history in 1984. On the basis of our experience, and our observation of other responsible and experienced reinsurers, 1984 was a bad year even for those reinsurers who did not engage in irresponsible competition.

We have long advocated that the criteria for entry into the reinsurance market should be substantially raised. As a practical matter, since alien non-admitted companies can engage in the reinsurance market, and are beyond the reach of our regulation, these higher standards would have to be implemented by limiting the conditions under which the ceding companies (the purchasers of reinsurance) would be permitted to take credit in their financial statements for amounts recoverable from reinsurers. We have long advocated, and continue to advocate such higher standards.

2. I would like to answer your questions in two parts. The first part deals with lines of insurance which we previously wrote, and which we no longer write. The second part deals with lines of insurance which we have not historically written and which we are not willing to write.

In both cases, as reinsurers, we reinsure companies rather than individual lines. The kinds of insurance written by the companies whom we reinsure determines the lines of insurance which we reinsure.

In my presentation, I described General Re's experience with medical malpractice insurance written on the occurrence form. General Re reinsured companies which wrote such insurance and, indeed, reinsured companies which specialized in that kind of insurance. Our decision to discontinue offering medical malpractice coverage on an occurrence basis stems from the fact that the loss development period for this line of insurance is in excess of twenty years. In other words, on an occurrence form, a policy covering a physician for the year 1985 will still be receiving newly reported claims after the year 2000. The question for the underwriter is how confident are you in your ability to predict the costs of the 1985 coverage, as those liabilities and costs will be assessed over the next twenty years. We concluded that we could not make reasonably reliable estimates of the basis of liability, standards of care, available defenses, statutes of limitations, etc., as they will exist five or ten or fifteen or twenty years in the future. Since we could not reliably estimate the costs, we discontinued the occurrence form. We do continue to provide medical malpractice reinsurance on a claims made form, and that requires that we estimate costs over a development period of about seven years. Frankly, in today's environment, we are not terribly confident in our ability to predict the status of the civil liability system, as it applies to the medical profession, on a seven year forward basis.

The effect of our action on primary insurers was probably to cause them also to discontinue offering the occurrence form. The reason for that is that General Re was one of the last reinsurers offering that form of coverage.

With regard to those kinds of insurance which we have not previously written on a broad scale, I should point out that we may reinsure some such risks in the course of reinsuring the overall account of a client company, however we would be unlikely to reinsure a company specializing in such risks. These classes would include municipalities, hazardous waste disposal, day care centers, directors and officers legal liability, pharmaceutical products. The reason for not reinsuring companies which specialize in such risks is, again, our inability to reasonably estimate the standards of care, available defenses, limitations of liability, measures of damages, etc., as they will apply four or five or six years in the future. Since we have not previously reinsured companies specializing in these lines, our decision not to enter these lines has no direct effect on primary insurers. If we could bring about changes in the civil liability system which would make it reasonably possible to estimate future costs of liability coverage for such lines, we might very well begin offering to reinsure companies specializing in these lines and that would, presumably, increase the willingness of primary companies to entertain such risks.

3. As you will see from the preceding answers, developments in the U.S. civil justice system over the past fifteen years or so, have almost entirely determined our attitude toward these distressed insurance lines. I would like to re-emphasize the point I made in my statement, that, in relying on past experience as an indicator of future costs, the underwriter must not only adjust past experience to reflect current conditions, he must project trends and anticipate future changes in the U.S. civil justice system to make a reasonable estimate of the costs of today's coverage as they will be assessed five or ten or twenty years in the future.

The underwriter's problem is complicated by the fact that he cannot rely on traditional principals of contract law. If he could, he could design an insurance or reinsurance contract which limits and conditions his exposure so that his future costs are reasonably determinable. In recent years however it has become apparent that contract language, and the intent of the contracting parties at the time of contract, will be disregarded, and contracts will be interpreted to achieve a social purpose, or to provide some remedy for an injured victim where no other remedy is available. If he is deprived of the ability to limit his liability by contract provisions, the underwriter must than view his liability as limited only by the rules and practices of the civil justice system.

The second part of your third question is extremely important. While attention is generally focused on jumbo jury awards, the more serious problem, in terms of overall costs in the system, is the effect of those awards on the settlement of cases which are not tried.

There would probably be comparatively little litigation if the only damages in issue were compensatory damages. The elements of damages which the parties are most likely to be unable to resolve are pain and suffering, and punitive damages. The threat of these kinds of unmeasurable damages influences the settlement value of every claim—so the expense of litigation, and the possibility of pain and suffering or punitive damages awards probably results in substantial increases in the settlement value of cases which are not tried.

General Re has no independent statistics on this point. Our experience would differ somewhat from the overall insurance industry because we typically write reinsurance on an excess of loss basis. The vast majority of risks written by primary insurers in the United States are not reinsured at all, and the vast majority of claims settled do not involve reinsurance. As an excess of loss reinsurer, our experience would reflect that portion of losses incurred by our ceding companies which exceeds the retention level of that ceding company. Obviously, as settlement values of cases are pushed upward, a greater proportion of claims will exceed the insureds retention. A little arithmetic will demonstrate that an 88% increase in overall losses may represent a 25% increase to the primary insurer (net of reinsurance) and a 300% increase in loss costs to the reinsurer.

We don't keep records which distinguish litigated cases from those which are not litigated since, as excess reinsurer, we are not involved in small cases, we assume that proportion of claims which are litigated are much greater than in the case of a primary insurer.

We have no way of distinguishing "threatened lawsuits" from "uncontested settlements".

4. Premiums established by the primary insurer represent the total premium collectible with respect to a particular risk or class of risk. In the reinsurance transaction, the primary insurer and the reinsurer agree on a division of that premium, however the reinsurance transaction cannot make up for a deficiency in premium charged in the first instance.

The influence upon primary insurers is indirect. If a primary insurer has underpriced the risk in the first instance, he will undoubtedly have difficulty reaching agreement with a reinsurer on an appropriate division of that premium. He will probably try several reinsurers, and if he is unable to reach an agreement with any of them, that will cause him to re-evaluate the original premium.

Reinsurers like General Re also consult with and advise primary insurers on loss reserving practices, both with respect to individual cases, and with respect to overall lines of business. The purpose of that consultation is to enable the primary insurer and the reinsurer to reach agreement regarding the appropriate division of premiums on the basis of the respective shares of incurred loss—including loss reserves. To the extent that these discussions influence the reserve levels established by the primary companies, they will also effect the premium levels established by primary companies.

5. No. Generally, no law prohibits American insurance companies from purchasing reinsurance from an insurer which is not licensed in his state of domicile, or which is not licensed in any state of the United States. Accordingly, there are a great many reinsurers in the market who are not licensed or entered to do business in the United States and who do not file financial statements with any state insurance commission.

6. I'd like to answer the second half of your question first. The laws regulating reinsurers are the same laws which regulate primary insurers. Reinsurers must meet the same capital and surplus requirements, must comply with the same investment laws, must adhere to the same risk limitation restrictions, must reserve for losses in accordance with statutory requirements, must submit to the same examinations, etc. Of course, all those regulations apply only to reinsurers who are licensed.

Since it is not practical, and not desireable, to prohibit U.S. insurers from purchasing reinsurance from unlicensed non-admitted reinsurers, the most appropriate course of action for the regulator of the primary company is to limit the conditions under which credit will be allowed for reinsurance in the statutory accounting statement of the primary insurer. General Re believes that the requirements for credit for reinsurance should be high, and we served on the Drafting Committee which drafted the NAIC model law on credit for reinsurance. So far about 20 states have laws on their books which meet the minimum standards of the model law. The laws are not evenly enforced among the states. Indeed, New York recently took the unusual step of expanding the allowance of credit for reinsurance in non-admitted reinsurers.

7. The contracts of most reinsurers do require primary insurers to report all claims which may reach the reinsurers coverage, and all incidents which may result in claims which would reach the reinsurer's coverage, promptly. Late notice by the ceding company may void the reinsurance coverage.

The reason for the late emergence of losses in the RAA loss development study is that these losses first become known to the primary insurers many years after the policy year to which that claim is attributable.

Your question does not quite accurately state the findings of the RAA study. What the study indicates is that is will be thirteen years after the end of the policy year before the number of claims associated with that year reaches 75% of all claims associated with that year. As described above with respect to the occurrence form of medical malpractice, that means the underwriter must, in order to price today's policy, make a judgment as to the state of the civil liability system thirteen years from now if he wants his estimate to reflect 75% of the expected losses. With respect to the other 25%, he will have to project even further into the future. This is the reason underwriters switch from the occurrence form to the claims made form of policy for "long-tail" exposures.

I hope these answers are responsive. If you have further questions, I shall be happy to answer them.

Respectfully,

EDMOND F. RONDEPIERRE.

The **CHAIRMAN**. Thank you, sir. Mr. Maisonpierre.

Mr. **MAISONPIERRE**. Thank you, Mr. Chairman.

I am Andre Maisonpierre, the president of the Reinsurance Association of America. I am accompanied today by Mr. T. Parrington Semple, the resident counsel and secretary of the American Reinsurance Co., I believe the second largest domestic reinsurance company.

All of our member companies are professional reinsurers, which are principally engage in the assumption of property and casualty reinsurance. They are either domestic U.S. companies, or U.S. branches of foreign reinsurers entered through and licensed by State. All of our companies are regulated by the various States in which they are domiciled or licensed.

Reinsurance is an insurance transaction whereby the reinsurer agrees to indemnify the ceding insurer or the reinsured against all or part of the loss which the latter may sustain. The transaction does not involve the policyholder who looks only to his insurer for defense and indemnity against loss.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry. Mr. Rondepierre has touched on the market distribution of reinsurance between U.S. and foreign alien companies and I will not touch on that. Let me just point out that since 1969, the net premium assumed by U.S. reinsurers has increased in excess of 600 percent, and that the market share of U.S.—the dependence, I would say, by the U.S. market on foreign reinsurers has diminished from 34.3 percent in 1969 to 27.7 percent in 1984.

Now since reinsurers indemnify primary and excess insurers for losses paid under their direct policies, they are impacted by the same legal and legislative developments affecting property and casualty insurers, except the impact on reinsurers can be compounded.

For instance, reinsurance contracts written in the 1950's and the 1960's for relatively low premiums are today responding pursuant to court decisions, retroactive legislation, and jury awards to claims which were never anticipated when these contracts were issued.

These unexpected liabilities have demonstrated to reinsurers the totally unpredictable nature of casualty risks and the liabilities which they create. Further, they have reduced the industry's available assets. You may wonder why these ancient contracts are responding to claims being filed currently. Well, the reason is the traditional general liability insurance policy provides for coverage of any loss arising from an occurrence which can be traced to the time the policy was in force, irrespective of when the loss is reported.

Although this delay creates some serious problems for all insurers, there is a marked difference in loss development patterns as between reinsurers and primary insurers. For instance, workers compensation a primary insurer is aware of about 75 percent of the losses it will incur on the first anniversary date on its worker's compensation book of business. The reinsurer only knows about 15 percent of the losses by that time. After the fourth year, the primary company knows all but 5 percent of the losses it will incur. The reinsurer is still unaware of 60 percent of its liabilities.

In the general liability area, a reinsurer will continue to be ignorant of large amounts of losses to be generated on contracts it enters in 1986 by the end of this century. Now these losses, nevertheless, will be adjudicated in the social, judicial, and economic environment which will then prevail, yet the premium to be paid for those losses must be collected in 1986.

The reinsurance industry has incurred growing losses over the past several years, and as a result its surplus position today has been reduced and its ability to provide a market has been constricted. Our statement details some of the changes which have taken place in the civil justice system, as well as in our tort laws in the recent past, and how these are adversely affecting the reinsurers.

The only conclusion which can be drawn from these observations is that commercial casualty lines of insurance are becoming so unpredictable in the losses which they will generate over time as to have become uninsurable. Predictability, as has been mentioned over and over again, is essential to insurance, and reinsurance pricing, and until the civil justice system is restructured, the availability of reinsurance in critical lines will remain elusive.

We are encouraged by the level of attention which problems associated with our tort system is generating, and we are particularly pleased with the constructive and imaginative approaches which this committee under your support, Mr. Chairman, has brought to the issue. However, we are disappointed with the level of legislative action by both States and the Federal Government which has been taken to date.

We believe that a fair balance between the interest of all parties can be achieved. In fact, unless such a balance is structured, the insurance and reinsurance problems which have been brought to your attention by your constituents will persist, and in fact will likely worsen.

Thank you very much.

[The statement follows:]

STATEMENT OF ANDRE MAISONPIERRE, PRESIDENT, REINSURANCE ASSOCIATION OF AMERICA

My name is Andre Maisonpierre, President of the Reinsurance Association of America, a trade association of professional reinsurers. Our member companies are professional reinsurers principally engaged in the business of assuming property and casualty (p/c) reinsurance and are either domestic U.S. companies or U.S. branches of foreign reinsurers entered through and licensed by a state. All the companies are subject to the regulatory jurisdiction of the various states in which they are domiciled or licensed. I am accompanied by Mr. T. Darrington Semple, Resident Counsel and Secretary, American Re-Insurance Company, one of the country's largest reinsurers.

We appreciate the opportunity to address the dual issue of availability and affordability of reinsurance.

Reinsurance is essentially an insurance transaction whereby the reinsurer, for a premium, agrees to indemnify the ceding insurer or reinsured against all or part of the loss which the latter may sustain under its policies of insurance. It provides reimbursement to the ceding insurers for losses which they sustain. Thus, it is a transaction which does not involve the policyholder who looks only to his insurer for defense and indemnity against loss. It is often described as the insurance of insurance companies because it provides reimbursement for the insurer's losses under policies covered by the reinsurance contract. Reinsurance is purchased by the primary or excess ceding insurer for its own benefit so that it can spread its risks and limit its own liability from large or catastrophic losses.

Reinsurance was developed to provide capacity essential to the continued growth of the direct insurance industry.

Reinsurance contracts are shaped to meet the specific needs of the ceding insurer. Despite the fact that there are no standard reinsurance contracts, there are two basic types which are used and adapted to accommodate the buyer's business. A reinsurance treaty is a broad and often automatic agreement that covers some portion of a particular class or classes of business, i.e., the ceding insurer's entire workers' compensation or property book of business. In contrast, a facultative agreement covers a specific risk of the ceding insurer and requires the insurer and reinsurer to agree on terms and conditions on a contract-by-contract basis. Both treaties and facultative agreements may be based on a pro-rata distribution where the two parties share proportionately in premiums and losses. The agreements may also be written on an excess basis, where only the losses of the insurer in excess of a predetermined amount, known as the "retention," are reinsured. It must also be noted that many reinsurers also provide direct excess insurance to policyholders, although this direct business generally represents a small portion of a professional reinsurer's entire book of business.

The 1984 U.S. property and casualty reinsurance market received approximately $11.3 billion in gross premium. Of this amount, $10.9 billion was for reinsurance assumed and $445 million for direct excess insurance. This represented less than 10% of the total net premium written by all property and casualty companies.

Further, many U.S. insurers purchase their reinsurance directly abroad. The U.S. Department of Commerce estimates that in 1984, in excess of $3 billion in net premium was paid to unlicensed foreign reinsurers. Another important factor to recognize in analyzing reinsurance premium distribution is that U.S. reinsurers, in order to achieve the needed risk spreading, must turn to the international reinsurance market just as the latter cedes some of its exposure to U.S. reinsurers. Although data recording these transactions are not collected systematically, indications are that foreign reinsurers assume a significantly larger portion of U.S. risks and, indeed, U.S. insurers paid $1.3 billion more in reinsurance abroad in 1984 than were received by U.S. reinsurers from ceding foreign companies.

The domestic reinsurance market has undergone rapid growth over the past 15 years. Since 1969, there has been better than a 6.6 fold increase in the net premium assumed by U.S. reinsurers. The dependence on foreign companies also has grown but their penetration of the U.S. market has been reduced from 34.3% in 1969 to 27.7% in 1984.

It should be observed that the extent of utilization of reinsurance varies considerably from primary company to primary company. A study [1] recently published by Conning and Co., an investment firm which conducts extensive financial analyses of the insurance industry, notes that among 26 primary underwriters studied, utilization varied in 1984 from a high of 46% of gross premium to a low of less than 1%. The average utilization rate for the 26 companies was 16.9% in 1984, an increase from 10.7% in 1975 for these same companies. Further, it is clear that those companies which tend to underwrite large or hazardous commercial risks are more dependent on reinsurance despite their higher retention levels.

For reasons I will describe in a moment the reinsurance industry today absorbs a disproportionate percentage of total insurance losses. The Conning Report observes that "for all the companies and during the ten years in this study, 116.4% of the cost of reinsurance was returned to the primary companies in the form of paid losses reimbursed or reinsured losses still collectible. *1984 was a disaster for reinsurers, with the above ratio deteriorating from 121% in 1983 to 173% in 1984.*" (Emphasis added.) [2]

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[1] "Reinsurance Use and Cost of Reinsurance versus Benefit—A comparison of Primary Property and Casualty Insurers," Conning & Co. (December 1985)

[2] A ratio above 100% indicates that reinsurers reimbursed primary companies for losses in excess of premium collected. Note that the study ignores the effect of investment income which, though important, could never offset the losses incurred by reinsurers, in 1983 and 1984.

Since reinsurers indemnify primary and excess insurers for losses paid under their direct policies, they are impacted by the same legal and legislative developments affecting property and casualty insurers. Any factors increasing the frequency or the amount of losses will increase the reinsurer's liability, although the effect on reinsurers can be even more dramatic than on direct writers.

The insurance industry's enormous and still expanding liability in the casualty area under general liability policies issued in the past has had and will continue to have a major influence on the present and future ability and inclination of reinsurers to continue to expose their capital and surplus in these same lines of insurance, until and unless major reforms in both the policy forms and the civil justice system take place. Experience on current and past policies is creating current and future liabilities of such unanticipated magnitude and unpredictable nature that the reinsurance industry finds it almost impossible to assess its present total responsibility.

Insurance policies and reinsurance contracts written in the 1950's and 1960's for relatively low premiums are now responding pursuant to court decisions or retroactive legislation to claims which were never anticipated under the contracts. The resulting impact on reinsurance has been traumatic.

First, these unexpected liabilities as well as other losses are draining the industry's policyholders' surplus and hence its ability to provide the capacity needed in all lines of reinsurance. Second, these losses have highlighted the totally unpredictable nature of casualty risks and the liabilities which they create and how these, in turn, can be enlarged by the courts and by legislators. Taken together, these forces are likely to discourage the reinsurance industry from writing risks it cannot understand, rate or limit with any certainty. Instead, it will likely commit most of its available capacity to product lines providing some profit potential. As a matter of fact, a reinsurer will need to adopt this behavior if it wants to remain solvent. It must do so for the benefit of all of its client companies and its shareholders.

As previously mentioned, the reinsurance industry is today absorbing losses from primary insurers disproportionate to the amount of premiums received. This is a relatively recent development. The ratios of loss and loss adjustment expenses to premiums for reinsurers and insurers were quite similar from 1980 to 1982. However, in 1983 the reinsurers' ratio exceeded primary insurers by 4% and 1984 by 15%:

	Reinsurers	Insurers
1980 (percent)	75	75
1981 (percent)	76	77
1982 (percent)	80	80
1983 (percent)	85	81
1984 (percent)	103	88

This, as well as the Conning Report, supports the contention that changes in the civil justice environment and the interpretation by the courts of insurance contracts in ways never anticipated by the insurance industry have had considerably worse impact on reinsurers than on the primary companies. Note, for instance, that in the early 1960's, it was common for a reinsured company to offer $5 million or $10 million coverage limits to a policyholder but retain only $50,000 or $100,000, respectively. All losses in excess of those retentions were then intended to be absorbed by reinsurers. However, since it was expected that the reinsureds retention would suffice to cover the majority of losses, the reinsurance premium paid was relatively small.

What has, in fact, happened is that those contract retention limits today are being reached and pierced with unexpected frequency in just about all lines of business as a direct consequence of the unexpected changes in the civil justice system. The result is that reinsurers' past and future liabilities on these contracts far exceed the premium received, plus all the investment income earned on the premium.

You may wonder why these ancient contracts are responding to claims being filed currently. The reason is that the traditional general liability insurance contract leaves the insurer exposed to claims filed many years after the insurance policy has expired since the contract provides for coverage of any loss occurring during the policy period irrespective of when the loss is reported. Certain exposures, particularly in the toxic tort area, are particularly susceptible to this latency factor which is generally referred to as the "long tail."

Although this delay in reporting creates serious problems for all insurers, there is a marked difference in loss development patterns between reinsurers and primary insurers. The major reason for these differences lies in the retention feature of excess of loss reinsurance. Since many claims are not valued at ultimate cost initially, the primary insurer may not report such claims to his reinsurer until considerable time has passed because the initial reserve is within the primary insurer's retention. The relative development is much larger for the reinsurer than the primary insurer since the primary insurer's net loss on any particular claim is limited for annual statement purposes to its retention. In addition, the primary company claim department has more direct control over the administration and adjudication of each claim. For instance, in workers' compensation, a primary insurer is aware of 75% of the losses it will incur at the end of the first year of the insurance policy. The reinsurer only knows of 15% of its losses by that time. After the fourth year, the primary company knows of all but 5% of the losses it will incur; the reinsurer, still does not know 60% of its liability.

PERCENTAGE OF ULTIMATE LOSSES

	1st year		4th year	
	Reinsurer	Primary	Reinsurer	Primary
Automobile liability	35	80	80	100
General liability (incl. asbestos)	3	50	20	85
Medical malpractice	2	45	20	90
Workers' compensation	15	75	40	95

Source: 1984 Best's casualty loss reserve development (for primary only).

This delay creates major problems for reinsurers in the anticipation of losses, and the consequent rating of future business on the basis of accurate loss information. For the past several years, we have been conducting studies in reinsurance loss development trends. In recent years, loss development factors have become larger. With few exceptions, each year's additional information has proved previous loss development patterns to have been optimistic.

It is no accident that the lines of insurance which are the slowest to develop—the long tail lines—are the ones creating the worst problems for reinsurers. For instance, in the general liability area—even excluding identifiable asbestos losses—by the end of the first year we know little more than 5% of ultimate losses, 30% by the end of the third year and by the eighth year only 60%. It is not until the thirteenth year that we know of 75% of the losses that will arise and we slowly hear of the remainder of the losses over the next two decades.

Assuming no change in the future loss development pattern, only a bare majority of losses on reinsurance contracts covering general liability exposures issued in 1986 will be known to the reinsurers by 1994; and, by the end of the century, there will still be large amounts of losses not known by the companies. Note that these losses will be adjudicated in the social, judicial and economic environment which will then prevail, but the premiums to pay those losses must nevertheless all be collected in 1986.

Is it any wonder then, that the reinsurance industry's underwriting experience over the past several years, has gone from bad to atrocious? The industry's combined ratio has shown a worsening in each of the past five years, culminating in an unbelievable 133% in 1984. In other words, reinsurers paid out $133 for every $100 in premium collected on losses, losses incurred, adjustment expenses, administration and commissions. No investment income, no matter what the interest rates may have been, could ever offset such losses.

U.S. reinsurance combined ratio [1]

Year:	*Percent*
1984	133
1983	119
1982	114
1981	108
1980	107

[1] A.M. Best—1984 Reinsurance Results.

This is particularly disturbing since, as a direct consequence, the reinsurance industry sustained a 7% decline in policyholder's surplus despite a large infusion of new capital in the industry. A.M. Best notes that "the reinsurers posted a negative 14% return on surplus" in 1984, as compared to a 3% negative return for the total property/casualty industry. Best further notes that today, the ratio of Net Liabilities to Surplus for the reinsurance industry exceeds that of the industry average.

What this all means, of course, is that the U.S. reinsurance industry's capacity has diminished substantially at a time when the need for our growing economy for insurance has increased. This capacity is lagging fully behind the expending needs for reinsurance. To reflect the level of solidity and solvency evidenced in 1982, reinsurers' surplus should have increased by 20%, not decreased by $30 million over the two year span ending December 1984. It should be noted that the decrease in capacity of the U.S. reinsurance industry coincides with a review of the continued participation in the U.S. insurance and reinsurance markets by Lloyd's and other alien companies.

It has been claimed by some observers that the current insurance-reinsurance market crisis is of the industry's own making. The inadequate rates charged in the past several years, as reflected by worsening underwriting ratios, are said to be indicators of "cut throat" or excessive competition.

No doubt, there was some excess, primarily led by new entrants into the insurance business who did not have sufficient knowledge to judge the consequences of excessively relying on investment income. But, what is often overlooked, is that insurance premiums had to reflect the extraordinary returns the industry was earning on its investments when interest rates were running 15% or 20% or even higher. Consider, for an instant, what your reaction would have been if insurers had not reduced premium in recognition of their investment returns and had reported unconscionably high profits.

The property and casualty insurance business is undoubtedly the most competitive of any business its size. No single company has enough penetration of any market to act as a price leader contrary to almost any other large commercial or industrial sector of the economy. It is probably this competitive environment which accounts for the industry's failure to have reacted promptly enough to the developing changes which took place recently in the civil justice system. As a result, the underwriting loss expectations have turned out much worse than anticipated.

You have already received extensive testimony on what has occurred to our tort system. No single index tells the tale and there are, no doubt, additional measurements which will come to light in the coming months to add to our knowledge. The evidence is clear, however, that present information demonstrates that the system cannot survive for long in its current structure.

Specifically, note the following:[3]

Civil lawsuits.—In 1984, there was one private civil lawsuit filed for every 15 Americans. There were 206,000 civil suits filed in the Federal Courts, an increase of almost 600% since 1940. By the end of 1985, new civil case filings were running at twice the level that prevailed in 1979.

Simultaneously, in 1984, our state courts had pending approximately 12 million civil suits.

Product liability cases commenced in Federal district courts have grown from 6,132 in 1979 to 13,554 in 1985.

Lawsuits against public officials have increased by 50% over the last 3 years. Today, 28% of all local governments have some lawsuits pending against them as compared to 14% in a 1982 survey.

Jury verdicts.—Plaintiffs today are winning a growing percentage of verdicts—47% in 1960; 60% in the late 1970's. The average size of verdicts has also increased significantly. During the 1970's, awards doubled in size. For products liability, the average annual size of jury verdicts increased from $237,462 in 1973 to $1,246,646 in 1984, a 525% increase. The medical malpractice average annual jury verdict grew from $166,165 in 1974 to an estimated $954,858 in 1984, a 575% increase.

Please note that all claims which are settled prior to verdict are affected by these jury verdicts since claim settlements are based on the expectations of jury awards.

If judgments in excess of $1,000,000 are excluded from the above numbers, the changes in the average cost of products and malpractice claims have been quite reasonable, approximately a 15% increase between 1978 and 1983. However, since 1975, there has been a 1,300% increase in the number of verdicts over $1,000,000.

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[3] See "Crisis in Liability Insurance—A Time for Change," Conning & Co. (November 1985)

Punitive damages.—The Rand's Institute of Civil Justice report on punitive damages demonstrates alarming trends in the two jurisdictions studied. The median punitive damages awards grew 600% from the early 1960's to the 1980-84 period in San Francisco (from $15,000 to $90,000) and 144% in Chicago's Cook County (from $9,000 in the early 1960's to $13,000 in 1980-84). The average punitive damages award also increased at a precipitous rate—in San Francisco 734% (from $65,000 to $477,000 in the above period and 549% for the same period in Cook County, from $98,000 to $538,000).

Although it is evident from the disparity in the average and median verdicts between Cook County and San Francisco that it may be inappropriate to generalize from this study, the available evidence would certainly justify major concern, at least in those jurisdictions, where multimillion dollar punitive awards have been reported.

Rising cost of defense.—Defense costs incurred by property and casualty insurers have increased 79% between 1978 and 1983 during which year $4.2 billion was expended in this category. Of this amount, $1.9 billion was accounted for in the general liability area. In 1983, loss adjustment expenses grew to 41% of indemnity losses in the general liability area and some industry observers fear that future defense costs will approximate 50% of indemnity payments.

Changes in tort law.—In addition to increased litigation and increased tort awards and settlements, there has occurred within the past few years dramatic changes in tort and insurance contract laws which have made prediction of future loss trends impossible. Consider, for instance:

The progression of a fault based system to strict liability to, more recently, in some jurisdictions almost absolute liability.

The elimination of comparative and contributory negligence defenses in strict liability cases.

The imposition of liability based on novel enterprise liability theories such as "concert of action," "market share."

Joint and several liability concept which allows recovery from any one of several defendants of the entire award, no matter the degree of negligence among the defendants. This has even been extended under federal law (Superfund) to apply when the defendant is an innocent, non-negligent participant in a lawful act. This results in major inconsistencies where an innocent or marginally negligent defendant who carries high insurance protection end up picking up the lion share of verdicts.

Judicial rejections of insurance contract exclusions.

The expansion of the "duty to defense" insurance contract provision and the imposition of punitive damages awards for "bad faith."

Continued increases in incurred losses.—Losses are determined by a combination of claims frequency and severity. The numbers recited above unfortunately clearly demonstrate that there is no let up in the current frequency and severity claim explosions. In fact, the latest available information shows that incurred losses are continuing to increase at a faster rate than premium increases (in 1984, premiums increased 9% while losses rose nearly 18%). What this means, of course, is that current premiums are still likely to be inadequate to pay losses which will be incurred on newly issued policies and further increases will need to be imposed on policyholders.

What about the future? Availability of an adequate reinsurance market depends on two factors:

1. The ability of the U.S. reinsurance industry to build up an adequate policyholder surplus base to sustain growth.
2. A change in the civil justice environment in which reinsurers must operate which will allow a return to profitability.

Surplus growth can come from two sources. One, is the funneling of outside capital into the reinsurance industry. The well established companies have been successful in the past several months in attracting new capital either through an infusion of capital funds from a parent or through the floating of stock issues. This certainly demonstrates faith in the ability of the reinsurance industry to come out of its slump and return to a profitable state. Not all reinsurers have been that fortunate, however, and some have served notice of intention to either quit writing reinsurance altogether or to limit their diminished capacity to the more certain lines of reinsurance.

The other source of growth is operating profits. As noted above, this avenue will improve if and when the tort system is revamped since those reinsurers with adequate capacity will funnel their resources in those lines which provide a certain degree of predictability. Predictability is essential to insurance pricing and it should be noted will be substantially enhanced once the new CGL contract forms developed by the Insurance Services Office are adopted. The RAA has supported the introduction of the new form since it will create, at least temporarily, some stability in the insurance market.

Ultimately, the availability of reinsurance in critical product lines, at affordable rates, will depend on the restructuring of our civil justice system. We are heartened by the level of interest shown by both state and federal governments on the issue, this Committee, under the leadership of its chairman deserves high marks for its willingness to consider innovative approaches to traditional remedy systems. However, we are not encouraged by the action which the various legislatures have taken to date to reform the tort mechanism. The issue has become overly politicized. It is, nevertheless, essential that the current system be revamped. We believe that a fair balance can be accomplished whereby adequate benefits are provided and manufacturers and others are fairly treated. Until such a balance is restored, the insurance and reinsurance problems which have been identified by your constituents and which will be described in testimony before this Committee are bound to persist.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. Reinsurers apparently suffered even greater losses in 1984 than the primary insurance industry. To what extent did the flood of reinsurers into the market prior to 1984 and the resulting low reinsurance prices contribute to those results?

Do these results suggest any need for stricter regulation of entry into the reinsurance markets?

Answer. Unquestionably the competitive furor of the early 1980's affected reinsurers as well as primary companies. Since reinsurance is a fungible product, U.S. reinsurers are subject to world competition and, as such, were under even greater pressure than primary companies. However, the changing patterns of the liability system, particularly, the combination of increased frequency and severity also played a major role in the disproportionate experience of reinsurers, since reinsurance losses are slower to develop and the premium collected to pay losses were collected so many years ago.

Although, it is tempting for established companies to suggest "stricter regulation of entry," we do not believe that restriction would be in the public interest. Both the primary industry, as well as the reinsurance industry, need an expanding capacity. What is important, however, is to insure that this capacity is long term, especially given the long tail nature of reinsurers. What this means is that we believe there should be increased standards for all reinsurers as some states, i.e., Illinois, have already recognized by imposing higher capital and surplus requirements for reinsurers than primary writers. We also believe that every state should enact the NAIC credit for reinsurance law and we comment further on this point under question 6.

Question. What commercial liability lines, if any, is your company steering away from and why? What is the effect of your actions on primary insurers who underwrite those lines?

Answer. Please note that the Reinsurance Association of America is not a company and all that we can comment on is the general impression which we have as to what each individual company may or may not be doing. Those of our member companies which traditionally had specialized in property reinsurance and might have only tangibly been in the casualty reinsurance area, likely have either withdrawn or curtailed their participation for lack of adequate expertise. Some other member companies which had been marginally in the facultative reinsurance arena may have pulled out of this reinsurance area which requires specific technical expertise.

It is difficult to say whether it is the reinsurers or the primary company which are pulling away from any commercial liability line. As noted in our statement, a risk is either insurable and, hence, reinsurable or it is not. One does not make a bad risk insurable via reinsurance.

To be insurable, an underwriter must be able to predict, with some degree of certainty, the anticipated losses which will be generated under the policy being issued. Unless the underwiter can anticipate the entire potential loss, the risk becomes uninsurable.

It is correct that the more difficult losses to anticipate are those which are slow to develop, as well as those which will generate high severity. Since a greater portion of those losses are likely to be in excess of the primary company's retention, reinsurers must assume a greater involvement in the underwiting of such risks. The reinsurer may disagree with the primary company as to the potential losses to be generated under the basic insurance contract, but if the risk to be insured can be priced, then it is only a question of distribution of the losses based on the primary company's retention program which controls the price to be paid for reinsurance.

The more difficult commercial liability lines today are environmental liability, which many underwriters believe to be uninsurable, as well as some professional liability lines, in view of the changing and unsettled status of public expectation as to the responsibility of certain professionals toward the general public; i.e., auditors. Similarly officers and directors liability insurance has become difficult to obtain because of the changing society expectations as to their responsibilities.

Question. To what extent have developments in the U.S. civil justice system influenced your decisions regarding distressed insurance lines?

Could you provide for the record the portion of claims paid as the result of court awards or threatened lawsuits, and the portion of claims paid through uncontested settlements, in those particular lines?

Answer. Reinsurers are in business to reinsure, not to reject risks. The developments in the U.S. Civil Justice System outlined in our statement have influenced individual companies' decisions to a very large extent. Let me give you an example.

Many of the general liability policies providing pollution coverage have specific exclusions for sudden or accidental acts of pollution. Furthermore, the policies also provided exclusions for losses occurring to a policyholder's property under its exclusive control. The courts have, in effect, wiped out retroactively both of these contract restictions. The effect is to expose insurers and reinsurers to environmental clean up costs of the policyholder's site. The Office of Technical Assistance estimates that it will cost close to $100 billion to clean up existing high hazard sites. The combined property and casualty insurance industry's equity is less than $70 billion, of which approximately $5 billion is the equity of domestic reinsurers. Yet, under many of the reinsurance contracts, it could well be that the major clean up burden will fall on reinsurers. This should explain the reluctance of reinsurers, as well as primary companies, to further extend their penetration in the environmental liability area.

Question. To what extent do reinsurers advise or influence primary insurers regarding the premiums the primary insurer charges a particular risk or class of risks?

Answer. The primary companies set their own rates. As noted above, those rates must be adequate to cover the entire exposure under the insurance policies. The reinsurer decides whether to underwrite on a portion of the policy based on the premium which it ultimately recieves as well as other factors, such as the primary company's management, the type of risk, etc. Everything else being accpetable, if the reinsurer and the primary company can agree on the distribution of the premium based on the expected anticipated losses which the primary company seeks to have the reinsurer assume, then the risk poses no problem. The greater the confidence which the reinsurer has in the underwriting competence of the primary company, the more likely will the reinsurer accept the underwriting decisions made by the primary company. Inadequacy of premium is not, of course, the only reason for a reinsurer to decline a risk. A reinsurer must have full confidence in the ability of its client companies to be able to handle the type of risk being underwritten in the first place.

Question. Are all reinsurers required to file financial statements with state insurance commissions?

Answer. Reinsurance licensed or approved in a state, as well as those that have entered a state through a trust fund approach (Lloyd's) must file the identical financial statements with state insurance commissioners as required of all licensed insurers.

Question. In a response to one of my questions for the record from the December 3rd Business, Trade & Tourism Subcommittee hearing, the Reinsurance Association of America stated that it favored strong "credit for reinsurance" laws for reinsurers, and the enforcement of those laws.

Do you feel the current laws regulating reinsurers are adequate, and do you feel those laws are adequately enforced in all the states?

Answer. Regulation and control of market entry must be balanced with a need for a broad marktplace. We have been very encouraged by the reception given the states to the NAIC Credit for Reinsurance Model law. The Reinsurance Association has urged the states to consider this model as a minimum act. Still, there are states that have lagged in their enforcement, but we expect that recent insolvencies have put the focus on reinsurance regulation and, hence, we anticipate stronger enforcement by the states.

We are concerned that the current availability and affordability crisis will prompt states or the federal government to allow easier entry into the insurance or reinsurance areas either by traditional insurance or reinsurance companies or alternative mechanisms such as captives or risk retention groups. Although we do not oppose the creation of these mechanisms, they represent only short term solutions which may, in fact, exacerbate the long term problems if those captives or risk retention groups are inadequately capitalized. One should remember that they too will be subject to the whims of the long tail loss developments and that they too will have to respond to claims filed many years in the future. The recent experience of captives which were formed in the late 1970's and early 1980's clearly points to the financial difficulties which they too can have.

Question. The Reinsurance Association of America's "Loss Development Study" indicates that 75% of the losses in general liability were known to reinsurers only after the thirteenth year of the policy.

Should reinsurers require primary insurers to report all claims as they occur so the reinsurer could reserve for future losses at an earlier date?

Answer. The problem with the slow development of reinsured claims is one of the most frustrating aspect of reinsurance. Reinsurers expect the clients to provide them with as much lead time as can be expected without overwhelming them with mountains of irrelevant information. Failure to provide adequate and timely claim information may well lead to cancellation of reinsurance agreements.

Currently, some reinsurers have begun to require that their clients provide them with notice of claims if the claim exceeds more than 50% of the primary company's retention rather than waiting until such time as the retention is likely to be pierced. However, in some areas—e.g., long latency cases, there will still be a long tail since the primary companies will also be affected by such tails.

Requiring the primary company to report all claims to its reinsurer would overwhelm the reinsurer, greatly increase the paperwork and would increase reinsurance costs.

The CHAIRMAN. Gentlemen, thank you.

Mr. Nader testified that in Canada where they have developed a tort system that apparently is much more restrictive than ours that they have had the same problems with the availability and cost of insurance that we have in the United States.

If we do change the tort system, if we would be able to do that, could you give us your assurance that the problem would be significantly mitigated?

Mr. SEMPLE. Mr. Chairman, my name is Semple. I was referred to by Mr. Maisonpierre. No; we cannot give you our assurances. The tort system does contribute to the problem we have at hand. Changing it will help alleviate it. It will not solve it. We still have to determine what is predictable. If we cannot predict with a reasonable degree of certainty the outcome of our underwriting——

The CHAIRMAN. I understand the theory, and I agree with it. I think that we should be engaged in tort reform, and S. 199 is the product of a long process of trying to work something out that we can get passed. But I know that as we proceed with this legislation, people are going to say, well, you know, why change the present system? It does have some benefits, I suppose. Mr. Nader certainly thinks that it does. And why change it unless it is going to have a real effect on people.

It would be a terrible situation if 1 year or 2 or 5 years after a tort reform bill were enacted we would be getting the same complaints, the same people would be writing us letters, and the same constituents would be talking to us when we are back in our States telling us that their insurance premiums are going through the roof.

Mr. RONDEPIERRE. Senator, I think it is important to distinguish between the absence, or nonavailability of insurance, and price. It seems to me that there are pockets of nonavailability, but the vast majority of the complaints are in fact price. I am sure we cannot promise you that price will not go up, if indeed tort reform is enacted. In fact, I would venture a guess that it will continue to go up, as everything else in the economy goes up.

When people said that the places that had established tort reform, or had made partial efforts at tort reform, had not realized improvements, I think what they were saying was the rates did not go down. They did not testify as to what the rates would have been if the tort reforms had not been implemented.

The CHAIRMAN. Well, Mr. Nader is telling us that the same situation exists, that you cannot get insurance in Canada, insurance has been canceled, and so on. If that is a fact, I mean if it does not make any difference, then it is a little bit difficult to argue that this is a cause that is worth fighting.

Mr. RONDEPIERRE. I have heard his testimony. I think the absolute availability of insurance is strictly a question of an opportunity for profit. In my paper you will find that we have stated that it has been our experience that it is fairly easy to attract capital to the insurance business where there is a reasonable expectation of return on equity. Ms. Walters testified as to what that return had been over the last few years, and that would account for why we had not seen capital flowing to the business during that time.

It is extraordinarily easy to enter the reinsurance business. In fact, in the heyday when companies were getting in, or acquiring companies, it seemed we had new reinsurance companies formed every day. If there is in fact a lack of availability of reinsurance in Canada, or of direct insurance, I think it is because people do not perceive the reasonable expectation of a fair return on equity. If they perceived that there was a return, the capital would be there.

Mr. SEMPLE. Mr. Chairman, Mr. Nader testified that there is, if you lose in Canada you have to pay the attorney's fees. There is a similar rule in the Federal courts in this country. In both Canada and this country, the rule is not followed too strongly. So there is tort reform and tort reform. If it is in name only, it is not going to help.

The CHAIRMAN. Are you familiar with S. 1999?

Mr. SEMPLE. I am trying to recall it as fast as I can.

The CHAIRMAN. It really is a staff document, as you know, developed by a lot of people. It is the present version of this process that has been going on. But I was curious, if you did know about it, to find out whether you think it is real tort reform as such.

Should we bag it?

Mr. SEMPLE. No. I think you could probably use it as a vehicle to go forward. I am trying to recall all—I did not read it again before I arrived today.

The CHAIRMAN. I am sorry. If you have any thoughts about it, we would certainly be delighted to hear from you, or any witnesses for that matter, or anybody in the room.

Mr. MAISONPIERRE. Mr. Chairman, our general counsel and our staff did work with your staff and had some input in the legislation. We think that you and your staff must be commended, because it is a very imaginative approach, one which has eluded many States.

You are introducing some concepts which are very different concepts, election-type concepts. The one question that many people have had is whether the legislation will attract some adverse election, for instance. It is quite similar to, in a way, to a program which was undertaken as an experiment in one of my former lives when I was with a different trade association in a program which preceded no-fault auto insurance.

We called it a guaranteed-benefits experiment when we experimented in New York State and in Illinois whereby automobile accident victims were given a choice either to elect guaranteed benefits, all of the economic losses and some pain and suffering, or go through the tort system.

We found that those that had a very questionable case would of course elect for the guaranteed benefits, and those that had relatively small losses would also elect for that. But the claims where there was a good case to be made for liabilities, that those cases opted to the regular tort system. Maybe the experiment was not in force long enough so that we really could not draw any conclusions, because it takes a great deal of time for the public to become informed of what is going on, and we had, particularly in New York State, we were very fortunate in having the cooperation of the media and the press which provided a great deal of publicity as to the existence of the program.

But we could not draw any conclusion as to whether this type of a voluntary election program would in fact either cut down on the amount of lawsuits, or cut down on costs to the system. But we used this as an experiment to try to gauge the acceptability of no-fault, auto no-fault insurance. And I am sure that the Alliance of American Insurers, which was then my employer, would be glad to make available to you and your staff all of the data emanating from that study.

The CHAIRMAN. I would very much appreciate it.

Gentlemen, thank you very much.

The final panel, Mr. Robert Moore, president of the National Association of Insurance Brokers; Alan Page, National Association of Independent Brokers; and R.C. Riley, representing the Independent Insurance Agents of America.

Gentlemen, you have been very, very patient and I appreciate your willingness to stick with us so long today. Mr. Moore, would you like to begin?

STATEMENTS OF ROBERT H. MOORE, SENIOR VICE PRESIDENT, ALEXANDER & ALEXANDER SERVICES, INC., PRESIDENT, NATIONAL ASSOCIATION OF INSURANCE BROKERS; ALAN G. PAGE, VICE PRESIDENT, JOHNSON & HIGGINS, REPRESENTING THE NATIONAL ASSOCIATION OF INSURANCE BROKERS; AND R.C. RILEY, CPCU, PRESIDENT, PEEL & HOLLAND, INC., REPRESENTING THE INDEPENDENT INSURANCE AGENTS OF AMERICA

Mr. MOORE. Thank you, Mr. Chairman.

I will be mercifully brief. I will summarize my statement, which has already been submitted for the record, and make some additional observations.

My name is Robert Moore. I am a senior vice president of Alexander & Alexander, and the current president of NAIB—the National Association of Insurance Brokers. Our members administered over $30 billion in premiums in 1985. My testimony can be summarized in five comments.

First, the availability/affordability crisis in liability insurance will extend for many more months. It could last until the end of 1987, or longer, for higher risk lines of business.

Second, although certain lines of insurance may become somewhat more available and affordable in 1987, the insurance crisis will continue to produce widespread economic hardships for our clients.

Third, not only is this situation bad for American consumers and American business, it is bad for the insurance industry. It is also very detrimental to the U.S. economy and our global competitiveness.

Fourth, from 1978 to 1984, insurance underwriters followed a policy of cash-flow underwriting. This gave consumers, as others have already testified, a temporary bargain. However, due to a convergence of very complex forces, the bargains are now gone and prices are spiraling upward.

Fifth, among the leading causes of the liability crisis are the dual phenomena that America has become an increasingly litigious society, and America's tort system is reeling out of control.

As you have already indicated, Mr. Chairman, the question has become, So what can your committee and others in Congress do about all of this?

As you know, Mr. Chairman, I am an ex-school teacher. I strongly believe in the value of the educational process. This is a process to which your committee is making a major contribution. As we move to a better understanding of the complex and interrelated dynamics of the business of insurance, I believe that broad-based constituencies will develop for such constructive changes as meaningful tort reform at the State and Federal level; and for an extension of the Risk Retention Act to cover liability insurance lines. My colleague, Alan Page, will be commenting on this shortly.

Other constructive changes in the months ahead should include:

Increased use of private dispute resolutions to settle claims before lawsuits are filed.

Greater emphasis on and investment in risk management practices and techniques which will help control potential liabilities.

Development of no-fault claims systems which can help to contain costly litigation and related expenses.

Corporations also should increasingly practice more preventive law by involving legal counsel in the process of developing new products and changing old products.

Mr. Chairman, in the months ahead, the NAIB and its members look forward to working with you, members of your committee, and staff in examining constructive and practical solutions to America's liability crisis.

Thank you, sir.

[The statement follows:]

STATEMENT OF ROBERT H. MOORE, ON BEHALF OF NATIONAL ASSOCIATION OF INSURANCE BROKERS

Mr. Chairman and members of the committee, thank you for the invitation to appear before you today.

I am here as president of the National Association of Insurance Brokers (NAIB), an organization of American brokers who, in 1985, were responsible for administering over $30 billion in premiums. Our members are large international companies as well as regional and local firms.

Clients of NAIB members include individuals and businesses of all sizes as well as municipalities and state governments, schools and universities, religious organizations and other non-profit entities. Their financial exposure ranges from thousands to hundreds of millions of dollars.

The brokers' primary responsibility is to protect clients' assets. We serve as intermediaries between insurance markets and the complex risk management needs of organizations and individuals. Our particular role in the insurance industry is to focus our specialized expertise, experience and resources to assist in managing financial exposures.

To meet these needs, brokers typically: analyze a client's financial exposure; suggest methods for reducing risks; assess insurance needs; develop relevant coverages; explain payment options; advise on claims procedures; and assist in handling claims.

Given these activities, we are particularly sensitive to how the current crisis in affordability and availability is affecting our clients—American consumers—and the businesses and organizations they work for.

Based on our experience in recent months, I am obligated to report that the current problems facing our clients are likely to continue through 1986 and well into 1987. While we believe that many of their problems will begin to be resolved over the next year or so, there will be substantial economic dislocation in the interim.

Quite frankly, Mr. Chairman, not only is this situation very bad for our clients; but, it is also harmful to the brokers' business and our industry generally.

A senior executive of one of our major members recently noted that the availability squeeze is forcing more buyers away from traditional insurance products and services. Driven by economic pressures, corporate and organizational buyers are finding alternative ways to insure risks. "Once these dollars are gone," from the traditional market, the executive reported, "they never come back."

My colleague, Alan Page, a vice president of Johnson & Higgins, will be commenting in a few minutes on some of the alternative methods brokers have used to meet our clients' insurance needs. I am submitting as a part of this testimony (Appendix A) some examples of brokers solving clients' problems nationally, as well as in such states as Missouri, New York and New Jersey. I would also like to submit as part of my testimony (Appendix B) [1] brief reports on public positions the NAIB has taken in recent months.

Mr. Chairman, your hearings are particularly welcome because the current debate shows signs of degenerating into a mad scramble to find the bad guys. If this happens, it will be a public policy travesty and a disservice to the American consumer.

There is no doubt that we have a severe crisis in the availability and affordability of liability insurance in this country, but we should avoid the good guy/bad guy syndrome. With all due respect to Mr. Nader and his colleagues, this syndrome is not a very helpful response to intricate problems.

The root causes of the liability insurance crisis are extremely complex and interrelated. In the best tradition of American pragmatism, we should work to understand the current crisis and then move to develop sensible, practical ways of responding to it.

As one of your colleagues in the House said earlier this month, "Insurance can only exist where risks are relatively predictable and can be spread. That is not the case today * * *. We need better insurance, not less insurance or a pie-in-the-sky illusion that the Federal Government can somehow pay the tab for all the risks that no one else is able to cover."

Not only is the current situation harmful to the immediate needs of our clients and to our own industry, but it also has very troublesome implications for the international competitiveness of American goods and services. The declining availability and rising cost of liability insurance also undermine American industry's ability to produce new products and develop new technologies.

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[1] The appendices are in the Committee files.

Anytime a business or organization is faced with substantial new costs of doing business, these costs influence the pricing structure of goods and services. In the current situation, the price of American goods and services are rising without a complimentary increase in their value to consumers.

While this morning's session is not an appropriate forum to thoroughly analyze the complex causes of the insurance crisis, let me mention briefly two leading contributors:

I. The most often-cited contributor is the remarkable explosion of litigation which the country has experienced in the last several years. While I am not here to render a judgement on whether or not our litigious society is a plus or minus for the body politic, it is certainly an extraordinarily expensive way for Americans to settle their differences.

As Chief Justice Warren Burger observed last year, "It is now becoming more and more clear" that in an increasing number of lawsuits "the total cost of the process is often equal to, or greater than, what finally goes to the pockets of the litigant seeking relief."

It is a cruel irony that in a country which prides itself on "equal justice under the law" that we have reached a point where legal fees and related transaction costs consume a very substantial portion of court awards.

I cannot improve on Justice Burger's declaration when he said that the time has "come for a careful, thoughtful, objective examination * * * of the whole litigation process under the common law system." Despite Justice Burger's exhortations and the well-known view of the insurance industry on this subject, the process of correcting even the most obvious abuses is likely to be frustratingly slow.

Despite the insurance industry's experience in this area, it must be candidly acknowledged that the industry cannot, on its own, bring about the needed reforms.

Despite the fact that one of America's leading insurance companies announced several weeks ago that it was taking a charge of $1.2 billion against its 1985 earnings, this will do little to bring about tort reform.

Despite the fact that the company publicly reported a substantial part of this loss was directly attributable to "the way in which today's court system interprets insurance policy liability and awards damages," statements such as these from the insurance industry will do little to bring about changes in the legal system.

Serious tort reform will only begin when a broad cross section of Americans come to understand that many of their goods and services are more expensive as a consequence of the costs generated by our present civil justice system.

Not only do these additional costs fail to produce added value, they result in the loss of jobs, undermine our international competitiveness and make the country more economically inefficient. These costs are creating severe economic pressures for particular industries and further eroding the trading position of U.S. firms in the world marketplace. These conditions will inevitably result in the withdrawal or consolidation of some markets.

When Americans ultimately come to recognize that the economic fallout from our present civil justice system may be too costly, then, and only then, will we have a serious effort at meaningful tort reform. And to be effective, such an effort will have to be led by a coalition representing labor, the legal profession, the business community, academia and others.

II. A second contributor to the current crisis is, regrettably, the underwriting practices of the insurance companies.

The chairman of my company, Jack Bogardus, has been speaking out about this issue for over a year. Mr. Bogardus has noted that for six consecutive years, from the late 70s until 1984, insurance companies competed frantically for business by cutting prices below adequate cost levels. Encouraged by high interest rates, underwriters abandoned their traditionally conservative underwriting practices and took up "cash flow" underwriting. Put very simply, companies discovered that they could underwrite at a loss and still make money through short-term investment of their premium income.

Although critics of the insurance industry do not seem to want to face this fact, these underwriting practices were, in the short-term, a boon for consumers. The facts are, consumers benefited from premium rates in just about every area of insurance. However, as with many bargains in life, it could not go on forever and obviously it hasn't.

Prices had to eventually go up and they have. And, because of the convergence of various forces, when prices did turn, they did so with a vengeance.

III. In addition to the forces I have already discussed, other contributors to the current insurance crisis include: the ubiquitous role of reinsurance in this country and internationally; the insurance companies' problems with their own solvency;

the insufficient staffing and inadequate funding which plagues many state insurance departments; the changing demographics of American society; and the diminishing sense of community which characterizes much of American life.

I cite these additional factors to underscore a fundamental point. The current predicament in which our country finds itself will not be amenable to quick or simple resolutions. The interrelationship of these factors is too complex for any quick-fix—no matter how ingenious or draconian.

What the country needs is a thoughtful analysis of the complex and interrelated dynamics of the business of insurance. Your committee is rendering a considerable public service by recognizing this need and by asking the various concerned parties to give their views.

I believe the insurance industry can withstand a public examination. As with most human enterprises, the participants do not in their heart-of-hearts really welcome being scrutinized. However, they also recognize the inevitability of scrutiny and debate in a time of difficulty.

I believe the industry, its employees and its clients can ultimately be well-served by the public debate which you, your committee and others in Congress have begun.

The CHAIRMAN. Thank you, sir. Mr. Page.

Mr. PAGE. Mr. Chairman, I also thank you for the invitation to appear before you today. I represent the insurance brokerage firm of Johnson & Higgins, a member of the National Association of Insurance Brokers. Johnson & Higgins is the country's third largest insurance brokerage firm.

In conducting our business, we represent a number of clients both large and small that are adversely impacted by the current insurance crisis. As brokers, we act as intermediaries between buyers and sellers of insurance. In addition, our function is to find or help develop new insurance capability or to provide alternative means for handling risks when conventional insurance markets cannot or will not respond to our clients' needs.

It is in this later role as organizers of new capacity, or as originators of alternatives to conventional insurance, that I address you today. The crisis that prompts this hearing has a particularly severe impact on commercial buyers of insurance, and liability insurance today is clearly the most stricken coverage with respect to pricing and availability. Clearly there is diminished capacity within the conventional insurance marketplace to underwrite commercial liability insurance.

This capacity shortfall has two dimensions. First, the capital necessary to support such underwriting is unavailable in sufficient quantities to lower prices and to make coverage more widely available.

Second, the willingness to underwrite such risks, even within those insurance companies that are well capitalized, has decreased severely. This lack of willingness is due to the dramatic decreases in support from reinsurers both within and outside the United States, which view commercial liability insurance as being too risky at any price. Their reluctance to extend reinsurance support to U.S. insurance companies is based on their perception that the U.S. tort system is out of control, a point commented upon by previous speakers at this hearing.

Reform of the U.S. tort system is a necessary solution to pricing and availability problems in insurance, but is at best long range. A more immediate step would be to facilitate the entry of new risk capital and new insuring organizations to alleviate this crisis. The insurance industry currently has a number of regulatory restrictions chiefly imposed by the States. These restrictions are part of the overall regulatory system administered by the various States. The fundamental purpose of the State regulatory system is to protect the public by regulating the solvency of the insurance companies.

This purpose is achieved through restrictions on entry, minimum capital requirements, regulations on investments, regulations on policy forms and rates, limitations on the amount of premium that may be written, and requirements for periodic reports and examinations.

This regulatory structure is supplemented by insurance guaranty funds that protect insureds if insurance companies become insolvent. All these measures are laudable with respect to protecting the public interest, but are obstacles in attracting new capital or new insurance companies to deal with the present insurance crisis. We need a balancing of the objectives of solvency and the need to create new underwriting capacity.

We propose—and I am speaking here on behalf of Johnson & Higgins—that this balance be struck in favor of retaining the traditional system of regulations to protect consumers and employees, primarily. However, that leaves a class of insureds, generally larger businesses and various professionals, which do not require the extensive protections given others.

During periods of insurance unavailability, such insureds have formed their own insurance facilities usually captive insurance companies. Captive insurance companies have been formed under special legislation found in but a handful of States, and in a greater number of offshore countries such as Bermuda. Captive insurance company laws recognize that certain insureds do not need regulatory protection offered to the general public.

Captive insurance company laws permit sophisticated buyers of insurance to form their own companies with a minimum of regulatory oversight. The Product Liability Risk Retention Act of 1981 made a statement on the part of the Federal Government that captive insurance company laws were desirable and needed at least with respect to product liability insurance. The Risk Retention Act extended the writ of such companies by permitting them to cross State lines and to help solve product liability problems of their sponsors with minimal State regulatory intervention.

The Risk Retention Act also exempted participants in risk retention groups from various securities laws that would otherwise hamper the flow of capital into their ventures. The Risk Retention Act is presently a valuable, albeit narrow, tool to assist buyers of insurance. And, again, speaking on behalf of Johnson & Higgins, and not NAIB at this point, we advocate the Risk Retention Act be extended to cover other liability insurance lines.

We support and expansion of the Risk Retention Act principally because of insurance needs to be met under its terms, and, therefore, do not have to be met by the conventional insurance markets and greater capacity will be available for consumer coverages and less hazardous risks. As a result, consumers and small businesses who are presently affected by the insurance crisis will have more insurance capacity relatively speaking than before, as hazardous commercial risks are insured by new companies covered under an expanded Risk Retention Act.

Specifically, we advocate expanding the Risk Retention Act to most forms of liability insurance not limiting it primarily to products and completed-operations liability, as the act currently reads. For example, we believe the Risk Retention Act ought to be broadened to include all professional liability insurance, including but not limited to insurance for accountants, architects and engineers, attorneys, and health care providers. In addition, specialty liability coverages such as fiduciary liability and directors and officers' liability should be included.

The Superfund reauthorization bill passed by the Senate last year extended the language of the Risk Retention Act to pollution liability only. Apart from broadening the scope of the bill, we request that the exclusion on using offshore domiciles risk retention groups be eliminated. Offshore domiciles for insurance companies continue to be the preferred home of captive insurance companies. In fact, the ratio of offshore to onshore insurance companies is on the order of 15 to 1. This preference is particularly true for association captive insurance companies, or those owned by a number of insureds.

The reason for their popularity offshore is because they can accumulate capital faster to retained earnings, since Federal income taxes are deferred on their profits until these profits are repatriated as dividends.

The CHAIRMAN. Could you sort of wind it up, Mr. Page?

Mr. PAGE. Yes.

The CHAIRMAN. Thank you.

Mr. PAGE. For example, A.C.E., an offshore company recently organized by Marsh & McLennan, also a member of the National Association of Insurance Brokers, provides liability insurance to large commercial enterprises. Under an expanded Risk Retention Act, it clearly would be a risk retention group that would enjoy the privileges of providing insurance without State regulatory roadblock. The formation of A.C.E. has permitted new capital to flow into the insurance industry and has allowed conventional insurers to write additional business that is not insured by A.C.E. A.C.E. is but one solution, and we need more of them—and quickly.

The insurance industry does not require Federal capital or Federal guarantees to solve the insurance crisis. As organizers of new capacity, we need only the means to attract and proceed to use new capital to insure risks that are not readily insured by the conventional insurance industry. Insurance provided by companies acting under the Risk Retention Act, as we propose it be amended, will not be a hazard to the public or to consumers. Rather, by allowing sophisticated buyers of insurance to meet their own insurance needs, we can preserve existing capacity for the public by providing new insurance protection for commercial buyers of liability insurance.

The CHAIRMAN. Thank you, sir. Mr. Riley.

Mr. RILEY. Thank you, Mr. Chairman.

My name is R.C. Riley. I am an independent insurance agent from Benton, KY. Independent agents, as you know, represent both the insurance company and the consumer, and this gives us a rather unique perspective on this issue, as well as other insurance industry issues.

I formally filed, as you know, our written testimony for the record. The testimony shows our concerns on the torts trends, reinsurance, company management, economic trends, and the competitive marketplace. Rather than reiterate my written testimony, I would like to make some personal observations today after sitting here and hearing all of the testimony. Perhaps it is best to go last. You have the opportunity to hear what is said.

I currently serve on the executive committee of the Independent Insurance Agents of America, and currently have the privilege of chairing the pollution task force that has dealt with many of the very difficult problems.

Let me say that Senator Simon this morning in the opening testimony used the word "frightened." He said that insurance companies were frightened. He said, I think that consumers were frightened. Well, I am here to tell you today, Senator, that insurance agents are frightened. Why are we frightened? Because we are vitally concerned with the solvency of our insurance companies.

The protection that we provide our clients is based on the financial ability of that insurer to respond at the time of a claim. That is what we are concerned about. You heard testimony today about how many companies have gone insolvent. The thing that vitally distresses me is not how many have gone, but the potential for future insolvencies, and they are great.

The independent agent has the responsibility to explain this crisis to the public, and I am here to share with you that that is very difficult at times. But I am here to tell you, Senator, today that I am very, I guess, pleasantly surprised that the average client today understands why insurance premiums have increased, and equally understands why we have an availability problem.

They understand that. And I am talking about the average client in Crossroads, America, rural America in Benton, KY, where I live. They understand the reasons, and they know that something has to be done, and they are looking to not only the insurance company management, but they are looking to Congress to solve the problem.

In my personal opinion, what we need to get out of this crisis is time, the time to let the economic and the competitive forces that made America great return to work. There is a known fact that where there is a potential in our economic system for a company to make a profit, there will be capital committed to make that profit. And in the absence of capital, you know that the best economic minds in the country from a business management standpoint do not think there is a possibility to make a profit.

I have done a study of my clients, and I have found that the average pricing that they are receiving in 1985, if you take into consideration inflation since 1979 for the average risk, Senator, the price they are paying is not that much higher than what they paid in 1979 and 1980.

You must remember these statistics sometimes when you talk about a 100-percent rate increase, I can tell you for a fact that most commercial insurance premiums were decreased 50 percent or more during the last 4 years. So when you return to what may have been normal 4 years ago, if you return to that you automatically have a 100-percent increase.

Now there are exceptions, of course, in the availability lines. I hope, Senator, that we have learned our lesson, not only the insurance industry but I hope that the crisis that the existing insurance industry is facing, I hope people in other industries will learn that you cannot continually have a price war without destroying your own organization and those around you, including your customers. You cannot do that, and that is what happened.

I hope that not only the insurance industry learns, I hope other businesses in this country learn. This crisis will pass when the insurance carriers begin to return and add surplus to their balance sheet. But you must recognize that the risks that are exposed to the real major problems in the product liability area, on environmental issues, the asbestos, this sort of thing will always have high premiums and continued unavailability.

Let me give you an example of a situation that, I think, needs to be said today. You have spoken and you have had several questions on why Canada, Mr. Nader, Ralph Nader said that they had tort reform in Canada but yet insurance was unavailable. Let me share with you that Canada has just passed a spill bill that deals with hazardous waste.

In Canada, a group of insurance companies on their own have gone together and formed a pollution liability pool that provides only sudden and accidental coverage. I submit to you that under the tort system in the United States, this cannot be done because of the existing judicial system, Superfund law, and our existing framework of law. You cannot do in the United States of America what they did in Canada. That is one case that can be documented of where the tort system in Canada makes insurance available.

I know my time is running short, but I do want to make two or three other points about the testimony that was given today and my observations, and I will be brief.

Senator **FORD**. Mr. Chairman, I will give him my time.

Mr. **RILEY**. I will be as brief as possible, Senator, and we will wind up today, unless you have questions.

It is amazing to me that the trial lawyers that some of the Senators alluded to at the beginning of the day, and some of the consumer groups headed by Ralph Nader, are adamant against changing the contingency fee system. Now the contingency fee system in this country is the way the trial lawyers earn a living, and the higher the court awards with the contingency fee system continuing, the more expensive our system gets.

In other words, the higher the contingency fees, the higher the awards, the more insurance costs. Now contrast that, Senator, with the fact that as an independent insurance agent I am compensated on commissions, based on a percentage of premiums. I am here today to tell you that I would like to see premiums decreased. Insurance companies would just as soon see premiums decreased.

Now that may sound absurd, but insurance companies made just as much money years ago when premiums were half, I'm talking about in the 1960's and 1970's, they got to the point in their surplus condition where they are today on premiums that are less.

In other words, as long as they have the predictability and measurability to make a small percent on the premium dollar, they really do not care what premium level there is. Do you see what I am saying? I am drawing a parallel between the insurance companies that would like to see the premiums decrease, which means their commission income would come down, but yet we would have availabilty and we could let an efficient agency work. We could make more money because we could have availability and meet the needs of our clients.

One further thing. I see some light at the end of this tunnel. I see in the insurance industry some very responsible chief executive officers of companies coming forward with responsible statements and actions; as an example, day care availability.

Those you that may have read recent trade journals see a major insurance company has come forth in the last 2 weeks with a program for day care insurance, and so insurance companies are responding.

In closing, I want to comment on Ralph Nader's position that reform of the tort system will be a major deterrent to the existing system. In other words, the existing tort system is a deterrent to certain types of actions.

I submit this will not happen if the changes are not dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair. Some tort reform is necessary to return a spirit of fairness and basic sanity.

We must take the greed factor out of our system. This is the reform that will be appreciated by the American public, which are my clients and your constituents.

Thank you so much for allowing me the overtime.

[The statement follows:]

STATEMENT OF R.C. RILEY, CPCU, ON BEHALF OF THE INDEPENDENT INSURANCE AGENTS OF AMERICA, INC.

Mr. Chairman, I am R.C. Riley, President of Peel and Holland Insurance Agency, in Benton, Kentucky. I am also a member of the Independent Insurance Agents of America Executive Committee, and Chairman of IIAA's Pollution Liability Task Force. As an insurance agent, I represent both insurance companies and the consumer—a position which permits a broader perspective on this and other issues otherwise common to the insurance industry.

In the brief time allotted, I'd like to outline a number of contributing factors to the availability/affordability crisis, and suggest some possible remedies.

Tort trends.—There's no getting around the fundamental importance of the tort issue. Whatever else may have contributed to the current crisis, and whatever else may be done to seek improvements in insurance markets, the long-term insurability of risks rendered uninsurable by the courts and law will only be restored by changes in the tort system. Such changes need be neither dramatic nor harmful to our fundamental interest in sustaining a civil justice system both accessible and fair. But a national reevaluation and reform of the concepts of fault, compensation, and evidentiary standards—to name just three—is reasonable, and could go a long way toward restoring the predictability, and therefore the insurability, of certain risks. Two more points about tort reform: (1) tort reform is a necessary but not sufficient response to the insurance availability and affordability crisis, and (2) it is not only an insurance issue. The country's tort system needs reform quite apart from the direct effect such changes might have on insurance markets.

Reinsurance markets.—The big missing link in today's insurance markets is reinsurance: the insurance insurance companies carry to permit coverage of large risks. The absence of this reinsurance capacity contributes to reduced overall availability and lower limits of coverage. Reinsurers' confidence has been shaken—or so they tell us—by the unpredictability of contract interpretation. And a return to American markets by reinsurers—again, we are advised from across the Atlantic—will be facilitated through use of a new "claims-made" contract which attempts to limit exposure strictly to the term of the policy. Finally, reinsurance costs, since they are largely uncontrollable, are a big factor in the affordability of insurance now available.

Insurance company management.—Having acknowledged the effects of tort trends and reinsurance on today's markets, the insurance industry must be clear-eyed and candid about its own contribution to the current crisis. We must recognize that something important has gone wrong with the way insurance companies plan and implement pricing and underwriting strategies, and anticipate market swings which could be better accounted for. The shift in income and profitability natural to the industry and now exaggerated by forces beyond the industry's control are at least aggravated by industry inability or unwillingness to chart for itself a more stable, economically sensible course and stick to it over time. Product underpricing when times were good, followed by ill-conceived efforts to make up lost ground too quickly, have almost certainly made a bad situation worse.

Another largely controllable reaction to the real availability crisis in lines of insurance such as environmental liability, has been to treat less obviously troubled risks with the same defensive mentality. To be sure, steps must taken to shore up reserves and protect against future, unsustainable losses where the courts and laws have conspired to render risks uninsurable. But not all risks have been similarly undermined, nor all underwriting made as unfathomable as the celebrated examples of pollution and professional liability. As my national association's President, Mr. Richard Taylor, recently remarked: "Underwriting is the science of trying to find a way of writing a risk—not trying to find a way to get out of writing it. It seems now the underwriters are trying in most cases to find a way to get out of writing a new piece of business." No amount of changes in the tort system or in reinsurance availability will prevent the persistent recurrence of today's crisis if not accompanied by industry reform of pricing and underwriting policies.

Economic trends.—More than most industries, insurance—because of long-term exposure, reserving against future loss, and claims losses—is affected by swings in the general economy. As the criticism of insurance company pricing practices in a high interest rate economy imply, the dramatic drop in interest rates over the past few years has taken its toll on insurance company profitability and surplus. All the more reason for the industry to avoid exaggerating this natural vulnerability by ill-conceived pricing and underwriting decisions.

Claims losses.—Statistical arguments are always slippery, but insurance industry statistics show an industry-wide net operating loss last year for the first time ever—and we believe them. Others' statistics reach different conclusions, and, beyond a rudimentary level of understanding quickly reached by those of us unschooled in the actuarial sciences, it is frankly difficult to know what ultimately will come of this furious debate. As an insurance agent, I know what I see in the market, and I see many of my companies hurting financially—in part from the self-inflicted wounds of price-cutting a few years back, but in part too from economic circumstances beyond their control. Until an objective, knowledgeable statistician can be called in to sort out all the numbers, the existing statistical evidence should signal caution in drawing firm conclusions or pursing policy decisions which could further weaken an already financially strapped industry.

Competitive marketplace.—Although highly regulated, the insurance industry is a member in good standing of the competitive, relatively free market. From this fact, a couple of general points should be made: (1) short of turning the insurance industry into a public utility of mandated, take-all-comers coverage, it is simply an economic fact of life that not all risks will be insurable at all times, or at low prices, and (2) criticism of, and proposed solutions to, insurance industry "cash-flow" underwriting bump up against this free market fact: the decision to offset underwriting losses with high investment income was also a decision to pass along to the consumer the benefits, in lower prices, made possible by that market. What would public reaction have been if at the time of record interest rate investment income the insurance industry had not competitively lowered the price of its product? These are the quirks and complexities of the competitive marketplace which must be taken into account.

With that outline of the multiple causes of the availability/affordability crisis, what can be done to help improve the current market?

At the federal level, very little. Where the federal government has offered insurance directly (flood, crime, riot, crop), the results have been costly and inefficient. Where it has mandated liability limits or created new exposures (trucking, pollution liability), the results have been to intensify market distortions. And where it has attempted, thus far unsuccessfully, to impose national standards of coverage (health and auto no-fault), the prospect of raising to a universal level the potential high costs and market dislocations which might otherwise be limited by state experimentation has been enough to dissuade past congresses. There are two areas, however, which may require or benefit from a federal approach. The first is federal product liability tort reform, probably necessary to account for the flow of products in interstate commerce. The second is amendments to the federal Superfund law (CERCLA) to facilitate the restoration of now unavailable pollution coverages by eliminating retroactive liability for risks never contemplated in pre-CERCLA insurance contracts, and by modifying the joint and several liability now imposed under CERCLA.

In the states, two avenues should be pursued. First, state-by-state tort reform to address in a modest but effective way the tort issues which may have the greatest long-term effects on insurance markets: costs of litigation, apportionment of fault, punitive damages, and others which may fit into individual state law contexts.

Second, state regulators now have the authority to ensure that insurance rates are neither inadequate (too low), excessive (too high), or unfairly discriminatory. That existing authority should be supported and used. Specifically IIAA recommends and supports regulation for company solvency, including disclosure of financial data and the strengthening and protection of state guaranty funds. We also support regulations requiring advance notice of mid-term cancellation, non-renewal, and premium increases.

Finally, in the market, we encourage, and are establishing through many of our state associations, voluntary, market assistance plans to help hard-to-place risks find coverage. Also in the market, although not universally endorsed by our state associations, and still an unknown quantity in terms of marketability and restoration of reinsurer participation in American markets, the new, industry "claims-made" form may help provide coverage where there is none now, and should be given a change to work.

Mr. Chairman, insurance availability is complex, and has no simple causes or cures. Insurance agents stand ready to help you and other members of congress better understand this issue, and pursue short and long-term remedies which reflect the public's interest in having a competitive, stable, financially sound insurance industry. Thank you—I'd be happy to answer your questions.

The CHAIRMAN. Gentlemen, thank you all very much for your testimony. I appreciate especially your suggestions of where we could go from here. Mr. Moore and Mr. Page have both referred to expanding the risk retention law. Mr. Riley talked particularly about tort reform.

You have heard today other witnesses, particularly Mr. Nader, take the position that the insurance companies are ripping off the country; gouging, I think is his word.

Do you think, as insurance brokers, insurance agents, that in some cases the insurance companies have been overdoing it and not writing insurance policies, not renewing policies, greatly increasing premiums, all the horror stories you hear?

Do you think that these are all justified by market conditions, or do you think the insurance companies have been guilty of a little bit of overreaching here?

Mr. MOORE. Mr. Chairman, from the experience of the national brokers, we do, quite frankly, see instances where premiums are too high. On many occasions we find that prices are considerably higher than our clients' financial exposure really justifies.

You had comments earlier today from individuals who have talked about the lemming instincts of the industry. In the past, there was a great rush to cut prices. Now there is a great rush to raise prices. In many cases today, the prices are steeper than compelling business reasons would justify. That is probably, more than anything else, a comment on human nature rather than a comment on indigenous industry practices.

The CHAIRMAN. Any other comments?

Mr. RILEY. Yes, Senator. I think in certain cases some companies in selected instances have overreacted. I think they have done it out of fear. I am not sure how any human being would react when they have their back to the wall and are faced with financial insolvency.

I think time will solve this problem, but in some cases there have been overreactions. State regulators that I have seen around the country are in the process of reacting to these overreactions, and I think each State has a mechanism in place to handle these situations.

The **Chairman**. Senator Ford.

Senator **Ford**. Mr. Chairman, I have all the confidence in the world in Mr. Riley. He has the unique background of having struggled through being an agent and is now representing the national association.

R.C., tell us. How much input do agents really have in the direction a company will go? How much influence do agents have over what the company's position will be on certain items as an independent agent?

Mr. **Riley**. Well, certainly we do not have as much influence as we would like to have, but to answer your question certain companies, and they are selected companies, value the input of agents and have what we call agents advisory councils, and we have direct input to top management of companies.

In the last 24 to 36 months, Senator Ford, the input from the agent has not been that great. I am not saying to you that companies do not value the input of the agents, because they recognize that the agent is on the front line having to explain all of these price increases and nonavailability.

My perception is that insurance company managements have had their hands full, and if you will look statistically at the number of insurance company CEO's that are in place today that were not in place 4 years ago, it is alarming. There has to be some consistency to insurance company management over the long pull.

We do have very limited input as individual agents, except through the national trade organizations like the NAIB, the broker's association, the Independent Insurance Agents of America, and others. We meet with companies, and the bottom line to your question is our executive officers at our associations are meeting with these companies, explaining to them on a one-on-one basis what problems are being faced by the agent and consumer in crossroads, America.

Very honestly, it is my understanding that company management is very sympathetic with this information. As I indicated to you a few moments ago, there are some very responsible people stepping forth in this industry and making some responsible statements. As I said, the day care centers by a major insurance company, that is a firm response to the problem.

Senator **Ford**. Mr. Chairman, I remember several years ago, it was very hard to place certain items such as surgical equipment. Finally the companies were able to work it out among themselves through associations or groups and find the coverage.

Let me ask all three witnesses. We have the Risk Retention Act. Should it be expanded so that small businesses and municipalities can group together for self-insurance? Is that something this group would approve, or should we not expand that ability on a national level?

Mr. PAGE. I favor expanding the Risk Retention Act to greater lines of liability. I think the capital and the willingness to take risks in these groups is out there. If you give us the tools by getting rid of the restrictions we have right now, we can do more for the public. We are waiting to do it.

Mr. MOORE. Senator Ford, as you know from having been a part of our business, we have an obligation to make available to our clients whatever funding mechanisms that are legal and viable. Anything you can do to help us meet our clients' risk management needs is all to the good.

Mr. RILEY. I agree with the statement that the consumer needs a viable alternative. I want to go back to my original statement that I think what we need before we make rash decisions is time.

I can see the Risk Retention Act being expanded to other areas will probably help some of those areas, and I can see some negative effects not only on the insured but possibly also on the agents involved. I would call, Senator, for an in-depth study of that issue before I expanded it into a number of other areas.

Senator FORD. We have people here that feel like Government ought to try to solve everything, and that is one of the problems we face today. Government has tried to be all things to all people and now we are beginning to find that we cannot be and basically should not be. We are getting into your business, and we should not be.

I think that we have to be very careful, but it is emotional out there now. I give you one item which I discussed with the chairman—and my caution light is on—one municipality in our State, Mr. Riley, said that it could no longer have insurance for a certain city service. The only notice they had is that the present carrier said it could no longer write this. The city discussed eliminating this service. Everybody got excited, but when several agents were asked, three proposals were put together by independent agents in that local community. They now almost have a bid basis.

You cannot go to the legislature in Kentucky or Missouri and say look, we cannot carry on because we cannot secure the insurance. They have had some. It has been canceled, and many times they have not looked anyplace else. Each company rests on its own bottom. They have certain things they can do, certain things they cannot do. That is the reason you do not want to be tied to one individual company.

I am preaching a sermon here on being an independent agent, but that has been my life up until January 1, 1985 and I am no longer in it. I have been voting present on insurance matters here, and I think you will find me taking a different direction now.

Thank you, Mr. Chairman.

The CHAIRMAN. I want to thank each of you very much. I want to thank everybody for being here today and for the patience that you have all exhibited.

There is going to be a second hearing on March 4, and the record will be held open until 2 weeks after the second hearing, which would be March 18. Some members will be submitting questions in writing, and my hope would be that all witnesses would be able to get their answers in before March 18.

Thank you very much, gentlemen.

[Whereupon, at 2:08 p.m., the Committee adjourned, subject to the call of the Chair.]

AVAILABILITY AND COST OF LIABILITY INSURANCE

TUESDAY, MARCH 4, 1986

U.S. Senate,
Committee on Commerce, Science, and Transportation,
Washington, DC.

The committee met, pursuant to notice, at 9:33 a.m., in room SR-253, Russell Senate Office Building, Hon. John C. Danforth (chairman of the subcommittee) presiding.

OPENING STATEMENT BY THE CHAIRMAN

The Chairman. Good morning. Today the Commerce Committee holds the second of 2 days of hearings on the availability and cost of liability insurance. We are well aware of the scope of the problem and its impact. At our first hearing, we examined the causes of the problem, and we looked at the basic workings and practices of the insurance industry.

This morning, we will focus primarily on the many solutions to the liability insurance problem that have been proposed. We will examine more closely such short- and long-term remedies as Federal regulation of the insurance industry, the establishment of a Federal reinsurance program, regulatory reform at the State level, industry changes in policy coverage, tort reform measures, and expanded use of self-insurance, risk pools, and captive insurance companies.

Special consideration will be given to S. 2129, the risk retention amendments of 1986. This legislation was introduced by Senator Kasten last Friday. Senators Hollings, Rockefeller, Pressler, and I are now cosponsors of this measure, which would amend the Product Liability Risk Retention Act to make it easier for businesses, associations, professionals, municipalities, and other organizations to form collective purchasing groups and self-insurance groups for general liability coverage.

This proposal is not a panacea. It is no cure-all for the current liability insurance crisis, but this expansion of the Risk Retention Act would provide some immediate relief for those affected by the unavailability and high cost of liability insurance.

There are differences of opinion as to the causes of our liability insurance problem, but I believe that there is general agreement that those seeking general liability coverage should be given such a greater opportunity to help themselves—especially when the insurance industry lacks the capacity to provide such coverage. As a consequence, I expect the committee and the Senate to act expeditiously on this proposal.

I now would like to welcome today's witnesses, with the hope and expectation that they will aid us in our efforts to review the liability insurance problem and to come up with an appropriate response.

Senator Hollings do you have a statement?

OPENING STATEMENT BY SENATOR HOLLINGS

Senator HOLLINGS. Mr. Chairman, today the Commerce Committee will continue its examination of a very serious problem, the high cost and unavailability of property-casualty insurance.

At our last hearing on this issue on February 19, the committee heard from many segments of the insurance industry. Today, we look forward to hearing from those who regulate the industry at the State level. We will also hear from the purchasers of commercial insurance. These witnesses will discuss the problem as it impacts them directly.

I also look forward to hearing from witnesses who will discuss the issue of expanding the Risk Retention Act. I am a cosponsor of S. 2129, legislation which will make it easier for certain entities to form risk retention groups or to purchase liability insurance on a group basis. These include municipalities, groups of professionals—such as nurse midwives—and businesses such as environmental commercial waste service firms. I am hopeful that S. 2129 will provide at least a partial solution to this complex problem.

Mr. Chairman, I commend you for scheduling these hearings. I learned a great deal about the insurance problem at the previous one, and I hope to gain an even better understanding from our witnesses today.

The CHAIRMAN. Do you have a statement Senator Pressler?

OPENING STATEMENT BY SENATOR PRESSLER

Senator PRESSLER. I again commend the distinguished chairman for holding hearings to examine the problems associated with the high cost and scarcity of liability insurance. These hearings are extremely important in providing a national forum in which we can explore and develop potential solutions to this serious problem.

We are all familiar with the effects of unaffordable or unavailable insurance. While we have all heard many isolated horror stories, I would like to take this opportunity to add some breadth to this issue.

I recently circulated a questionnaire to the residents of my home State of South Dakota asking them to indicate any changes in their commercial insurance premiums and coverage. We received 600 responses from all sectors of the economy—business owners, professionals, and Government officials: 32 percent of the respondents indicated their liability insurance had been canceled in the last year; 84 percent saw their insurance premiums increase in the last year; 34 percent of those who experienced premium hikes saw increases ranging from 100 to over 500 percent; motor carrier insurance was the most troublesome line; 22 percent said they experienced difficulties with this type of insurance while 18 percent indicated problems with health care and medical insurance; professional malpractice—16 percent, directors and officers—8 percent, and governmental insurance—7 percent, were also major sources of hardship.

It is clear that the insurance crisis is reaching far across our society and deep within our economy. The need for ways to alleviate this problem and prevent it from recurring is also clear. However, any solutions Congress or the States develop must be tailored carefully to address the specific, root causes of dramatic premium increases and severe coverage shortages. To accomplish this delicate task we need accurate, reliable information.

During the past several weeks, I have made very clear my sense of frustration over the apparent lack of solid empirical data that would demonstrate the relationship between the tort laws complained of by the insurance industry, and the current price and scarcity of insurance. It appears that the insurance industry's statistical and data gathering organizations do not have the information. Apparently, the only place we will find it is with the individual insurance companies. Therefore, I have begun discussions with several major commercial insurance companies to determine the feasibility of conducting a closed claim study in certain distressed lines of commercial liability insurance.

In 1976-77, The Insurance Services Office, an insurance industry statistical and rating organization, initiated the "Product Liability and Completed Operations Closed Claim Survey." The study collected information from over 24,000 closed claim data survey forms submitted by 23 major property-liability insurers. The purpose of the survey was to collect the information necessary to analyze quantitatively the product liability problem, and determine how the situation at that time might be turned around. The study also compiled a large base of claims data which could be used to evaluate various legislative alternatives to the tort system.

Given the serious nature of the present liability crisis, and the pressing need to address the problem, a closed claim study in distressed commercial lines could assist greatly in developing the solutions that will address this problem adequately and appropriately. Before we formally request such a costly and time-consuming study, however, we must determine whether it would yield information that will serve this important purpose.

Again, I congratulate the chairman for his leadership in addressing this crucial issue, and I hope that today's witnesses will help provide us with more guidance on what role, if any, the Federal Government should assume in this area.

The CHAIRMAN. Senator Gore.

OPENING STATEMENT BY SENATOR GORE

Senator GORE. Mr. Chairman, again I want to thank the witnesses for taking the time to share with this committee their insights on the problem of cost availability of liability insurance. In this, the second day of hearings by the full committee, we should focus on the possible long- and short-term solutions to this problem, keeping in mind that the causes of the current cost and availability crisis are varied and complex—and that, therefore, there is no single and simple solution.

I look forward to the testimony today of my senior colleague from Tennessee, Senator Jim Sasser, who has held hearings in Tennessee under the jurisdiction of the Small Business Committee and will discuss the impact of the current situation on businesses in our State. We will also hear from a representative of the Tennessee Municipal League, Mr. Jack Floyd, who will discuss the experience of the pool arrangement among Tennessee cities—its success and the obstacles it has encountered. We will also hear of the need for extension of the Risk Retention Act to permit additional groups that cannot obtain liability insurance to band together to provide coverage.

In discussing all of the potential remedies—these and others—we must be mindful of two opposing needs—the need for prompt action to prevent businesses from closing their doors for lack of coverage—and the need to carefully consider proposals for far-reaching change the ultimate impact of which may be much more fundamental than we can anticipate.

The CHAIRMAN. Senator Rockefeller.

OPENING STATEMENT BY SENATOR ROCKEFELLER

Senator ROCKEFELLER. Mr. Chairman, thank you for holding another day of committee hearings on the insurance crisis. As you know, I consider this subject a particularly worthy one for this committee's attention.

Last week, we heard from the insurance industry, agents, reinsurers, and consumers groups, among others. All agreed that there is a crisis gripping the insurance industry; however, its causes, how long it will last, and its solutions were disputed.

While the jury may still be out on many of these questions, it's essential, in my view, that Congress move now to find some practical ways to ease the crisis. While the long-range solutions may not rest with congressional action, we need to provide some degree of interim help for our counties, cities, small businesses, and professionals.

At minimum, Congress should pass the legislation introduced last Friday by Senators Kasten, Danforth, Hollings, and myself. Our bill provides municipalities, professionals, associations, and businesses with the latitude they need to help them through the insurance crisis. The Risk Retention Act Amendments of 1986 broaden the Product Liability Risk Retention Act of 1981 to give these groups the same insurance options that manufacturers now have; that is, it allows them to form insurance pools. While this proposal is not the cure-all for the current insurance crisis, it should give a wide range of insurance buyers some immediate relief. This is a good self-help remedy for those who have been turned away by the insurance companies.

The Risk Retention Act Amendments of 1986 is one step in the right direction. Yet, we need to devise additional creative solutions to this crisis. I am looking forward to hearing from the witnesses today and hope that they can provide some fresh insights and ideas.

I would like to tell the committee about one witness we have here today—Paul Flanagan, president of the county commission in

Raleigh County, WV. In January, Raleigh County lost its insurance coverage. Raleigh County commissioners, fearing personal liability, transferred all the county's prisoners to another jail and released 9 inmates; shut down 11 county agencies and 2 parks; and blockaded all but one door to the county courthouse. Fortunately, 2 weeks later the county found a company that would cover them—a Turkish insurance company! When local governments in this country are forced to seek insurance coverage from overseas companies, the whole system is in trouble.

Again, I thank you for holding this hearing, Mr. Chairman. I sincerely hope that this will not be the end of our work on the insurance problem. Over the next few months, it's important that we obtain further information from the insurance industry to help us get to the bottom of this problem that now pervades American life.

The CHAIRMAN. Senator Kassebaum has plans on attending, but in the meantime I will insert her statement in the record.

[The statement follows:]

OPENING STATEMENT BY SENATOR KASSEBAUM

Mr. Chairman, today's hearing will provide additional evidence of a crisis facing American businesses, communities, and consumers. I believe we have the ability and the opportunity to moderate this crisis, if we have the courage to press ahead for reform of our liability system.

In the 98th Congress, this committee acted by favorably reporting S. 44, a product liability reform bill which attempted to address the growing problems faced by United States manufacturers. Floor action was, unfortunately, not possible. Last May, this committee again tried to act by reporting S. 100, a modified version of S. 44. Again, progress was delayed.

Last December 3, the Business, Trade, and Tourism Subcommittee held a hearing on the impact of the tightening liability insurance market. On February 19, the full committee held its first hearing on the availability and cost of liability insurance. Last week we listened to testimony on the latest product liability reform vehicle, S. 1999. Today we will once again receive testimony that our liability system is out of control.

I will not go so far as to blame the entire property and casualty insurance crisis on our product liability laws. I will, however, state clearly my belief that the insurance availability and affordability questions we are exploring are linked closely to the lack of action on tort reform. One conclusion must be evident. We can alleviate much of insurance crisis by developing a consensus on product liability reform.

Critics of product liability reform may argue that the insurance industry is "creating a crisis" in order to spur tort reform efforts, and they may call for more federal regulation of the insurance industry. I agree that we need to understand better the practices of the industry and the implications of the practices of international reinsurers. But, more importantly, we need to understand that insurance must be based on predictability. Our liability system lacks that predictability, and we will not resolve our insurance problems until we restore some measure of foreseeability to insurable risks.

Our effort must have three objectives: compensation for innocent victims that is timely and fair, treatment of product manufacturers that is reasonable and just, and insurance that is available and affordable. If we can take the steps necessary to approve S. 1999, I believe we will achieve these objectives.

The CHAIRMAN. Senator Sasser is to be the first witness. Is he here?

Senator HOLLINGS. I think he is down south, Mr. Chairman.

The CHAIRMAN. Is Mr. Hazell here?

Mr. HAZELL. Yes.

The CHAIRMAN. Would you care to come forward?

Mr. Hazell, thank you very much for being with us. Mr. Hazell is a member of the council of Lloyd's of London.

If you could speak directly into the microphone. Thank you, sir.

STATEMENT OF RICHARD D. HAZELL, MEMBER OF THE COUNCIL, LLOYD'S OF LONDON

Mr. **Hazell.** Mr. Senator, good morning. Thank you.

My name is Richard Dennis Hazell. I am a member of the Council of Lloyd's, which is an honorary position. I earn my living as an active nonmarine underwriter. That is to say, I accept or decline the risks which are shown to me from the United States and elsewhere in the world on a daily basis. I am here at the invitation of this committee, which I understand is examining the availability and cost of liability insurance.

My purpose today is to inform this committee concerning the position of Lloyd's, and to do that I should like first to deal briefly with the constitution of Lloyd's. I should stress at the outset that Lloyd's is not an insurance company, but an insurance market, which is international in every sense of the word.

It is made up of individuals representing some 70 nationalities who with unlimited liability write insurances each for their own account and not one for another. The strength of this system is that all underwriters are gathered into a single marketplace where, in addition to competing one with another, they are in competition with insurance companies both at home and abroad. The primary concern of a Lloyd's underwriter is to endeavor, by applying sound underwriting principles, to make a profit on his underwriting business.

There are currently more than 28,500 members of Lloyd's and they include nearly 2,400 U.S. citizens, who incidentally provide some 10 percent of Lloyd's capacity. Members operate in groups known as syndicates, which at present number approximately 400. Each syndicate is managed by on underwriting agent who is directly responsible to the members for whom he acts in respect of all matters relating to the conduct of their underwriting business.

All business placed at Lloyd's must be effected through a Lloyd's broker. There are currently 258 firms of insurance brokers who are qualified to enter the underwriting room at Lloyd's for the purpose of placing insurance business with Lloyd's underwriters.

Under regulations which have been in force for many years, no firm of insurance brokers is admitted into the underwriting room at Lloyd's unless it is fitted to undertake the responsibilities which such a status involves. This does not mean that such a firm places insurance for its principals solely with Lloyd's underwriters. These firms can and do use all markets.

Indeed, it is their duty to find a market which will provide for their clients the best terms consistent with security and good service. Even within the Lloyd's market, the broker well knows that individual underwriters are in competition with one another, and if he fails to find the best market there is every likelihood that another broker, his competitor, will improve on the quotation.

Lloyd's has existed for more than 300 years and currently operates pursuant to an act of Parliament sought by Lloyd's to strengthen its self-regulatory powers. This is known as the Lloyd's

Act of 1982, and we have submitted a copy, Mr. Senator, as exhibit A.

This created the Council of Lloyd's as the governing body of the society, and at the same time it charged the council with the management and superintendence of the affairs of the society and the power to regulate and to direct the business of insurance at Lloyd's.

It is against this background that I would like now to say something about Lloyd's involvement in the United States, which began nearly a century ago. By 1984, the last year for which I have figures, nearly 70 percent of Lloyd's business was in U.S. dollars, and in the important nonmarine field a very high proportion of that was in U.S. situs business.

I make this distinction because all Lloyd's U.S. dollar premiums, no matter where in the world they may be earned, are held by U.S. trustees, Citibank, in the United States in what is called the Lloyd's American trust fund. These funds, which today stand at $6 billion, are invested almost entirely in U.S. Government or Government agency issues, making Lloyd's collectively one of the largest, private investors in such securities.

Thus, the American insurance industry is not exporting billions of dollars to Lloyd's, as has been alleged, since every cent of Lloyd's U.S. dollar premiums are retained in this country, where they are kept voluntarily and invested. This is true not just for U.S. situs business, but for all Lloyd's U.S. dollar business wheresoever it is derived.

The only payments which are made from the funds are claims settlements and ascertained profits at the end of each year of account. Also, as alien insurers privileged to do business in this country, Lloyd's underwriters over a 15-year period through to the end of 1984 paid enough U.S. income tax to make them the second largest contributors to the Internal Revenue Service of all U.S. property and casualty companies.

Moreover, Lloyd's underwriters are accredited reinsurers throughout the United States, eligible excess or surplus line insurers in all jurisdictions, as well as being licensed insurers in Illinois, Kentucky, and the U.S. Virgin Islands. In addition, a number of Federal agencies have recognized Lloyd's, as evidenced by the leading role traditionally played by underwriters in the reinsurance of the Overseas Private Investment Corporation. Consequently, Lloyd's files each year audited financial statements with the U.S. Treasury Department, many State insurance departments, and the National Association of Insurance Commissioners.

Lloyd's commitment to the United States is therefore considerable, and the suggestion which has been made in some quarters that we are seeking to pressurize U.S. insurance companies by boycotting their business is manifestly untrue. Indeed, were underwriters at Lloyd's to react in this way to what is admittedly a very serious situation, they would jeopardize some of their most important accounts, while alienating those with whom they have long enjoyed close business ties and personal friendships. The fact is that Lloyd's losses on U.S. general liability business reflect those suffered by American insurers.

Lloyd's leaves its accounts open for 3 years. This conservative rule enables us to present a more accurate picture of a given year's trading than would be the case were we to draw the line at the end of 12 months. Thus, 1982 is the last year for which complete figures are available. Out of the nine statutory accounts, eight broke even or made a profit, in some cases a very handsome one.

The ninth, the worldwide general liability account, the vast majority of which came from U.S. dollar liability business, consisted of premium income of 346 million pounds, plus investment income of 142 million pounds, claims and expenses of 802 million pounds, producing a net overall loss of 314 million pounds.

In other words, this one class of business, which generated only 12 percent of Lloyd's total premium income, was responsible for virtually 100 percent of our losses. Nor, as I have seen reported, are these results distorted by the adverse sterling-dollar exchange rate. Due to Lloyd's American trust fund, the only effect a fluctuating rate of exchange can have on our U.S. dollar balance is to increase or decrease, in sterling terms, an ascertained profit or loss as accounted to the members at the end of 3 years.

Although these returns relate to 1982, there is every sign that those for the recently closed year 1983 and for the open years 1984 and 1985 will be as bad, and according to some predictions even worse. That being so, members of Lloyd's might well ask why underwriters should endanger their accounts by persisting with this class of business when they might profitably do what they have been accused of doing, which is to pass by on the other side and leave someone else to solve the problem.

Fortunately, however, continuity is one of Lloyd's virtues, as many insurance and reinsurance buyers of major U.S. companies will confirm, having placed business with us for many years. Underwriters are currently making strenuous efforts both to quote terms which they can justify to their members and which their clients will be able to afford.

However, the length of time they can continue to do this must ultimately depend on a combination of three factors. A rating structure commensurate with the risk, our clients' acceptance of the claims made form, and the ability to close our books and determine profit or loss within a reasonable period.

The case for a more economic rate structure is, I believe, well made by the figures I have already quoted. But I would like, if I may, to give you one or two more. From a book of municipal liability business placed in Lloyd's, the current incurred loss ratio—that is, those losses already paid together with reserves for those outstanding losses still to be paid—over a 4-year period is an average of 425 percent.

On a book of directors and officers liability business, which has been placed in the London market, the incurred loss ratio has never at any time over the past 5 years bettered 200 percent. And, finally, a statistic that you may have heard before, the cost to the insurance industry of asbestosis.

To date, some 40,000 cases have been notified and the final bill is being spoken of in billions of dollars. To handle this problem, which is industrywide, the Wellington Committee was set up at Lloyd's instigation and an agreement was signed here in Washington in June of last year, the first claims being settled 3 months later.

The committee maintains a central register involving insurers, and producers, and manufacturers in the asbestos industry, and its aim is to speed the flow of money to injured parties. The sad fact is that 66 cents in every dollar paid out in claims goes, not to those who have suffered, but as plaintiff's and defendant's fees and expenses. Imagine the additional costs this places on insurance premiums.

The argument for a claims made form for insurers is irrefutable. Without it, we cannot stay in business, as it would mean leaving a trail of paper behind us which many years later could be presented as total losses, very often as the result of an interpretation being placed upon a policy wording which it was never intended by either principal should apply.

The position has been created, therefore, where, if the insurance industry cannot be convinced that the wording of their policies will prevail, they must adopt a different course, that being to shorten the period of time between the event and interpretation.

In this way, the intention of the policy will be more easily understood should it be contested in court. This is being brought about through the introduction of the claims made form, by which the event I spoke of a moment ago becomes the time the claim is made rather than the date of the original occurrence.

The insurance industry is responsible to its shareholders or, in the case of Lloyd's its members, and of course its policyholders. By moving to a claims made form, it is not, as has been suggested, avoiding responsibility, but is I believe safeguarding the interests of those who provide the security against which risks may be underwritten.

While the insuring public will hold policies which protect them against any claim made within the duration of those policies and will have the same protection in the future as each recurring renewal will be written on the same form as that which they already enjoy. The benefits, I am convinced, will accrue to insurers through a greater awareness of their immediate costs and to policyholders through more stable premiums.

As to the question of tort law reform, I am neither a lawyer nor an American. Discretion and good manners therefore suggest that I should limit my observations to the consequences if the present situation continues. Insurers and reinsurers at Lloyd's have determined that the current lottery they face in writing American casualty business can no longer be supported.

I have chosen the word "lottery" carefully, as it appears to me that this is what underwriters contend with when presented with a potential claim. In the first instance, there arises the question of location of the trial. Will the plaintiff obtain the advantage of a local and sympathetic jury? Will the jury be knowledgeable enough to fairly evaluate the worth of what is very often extremely involved expert testimony?

And then, of course, there is the question of punitive damages. These have become the bane of insurers' lives and are in my view largely responsible for the position the insurance industry finds itself in today. Although, as the name suggests, intended to punish wrongful actions, they are currently being used as a method of coercing insurers to compromise their position and their policies to save themselves from excessive punitive awards.

These then, together with bad faith actions very often asserted by the insured against his insurers, have given rise to the situation where casualty insurers, and as a result casualty reinsurers, are unable to quantify in monetary terms the risks they are being asked to run. Being professional and owing a duty to their own investors, their duty would seem to point to withdrawing from this class of business in favor of something more predictable.

However, as I have already stated, Lloyd's has a historical commitment to the United States and, providing that underwriters can see some measure of movement toward predictability in the factors I have detailed, a market will always be available at Lloyd's for American business, though I should perhaps sound a note of caution.

Although the capacity of the Lloyd's market has increased this year, in U.S. dollar terms, by approximately 40 percent, it can still write no more than 2 percent of the total liability business generated in the United States. Of course, it is very flattering to read that the buck stops at Lloyd's, but in reality it does not. It stops where it always has done, here in the United States, though not on this occasion in the Oval Office, but in the pocket of the consumer.

Senator, gentlemen, thank you.

The **Chairman**. Mr. Hazell, thank you very much. Before we proceed with questions for you, sir, Senator Sasser has now arrived. And Senator Sasser, would you like to proceed?

Mr. Hazell, you can just stay there if you like.

STATEMENT OF HON. JIM SASSER, U.S. SENATOR FROM TENNESSEE

Senator **Sasser**. Mr. Chairman, thank you very much. I apologize for being a late this morning, but I am sure the chairman and the distinguished ranking member, knowing the press of business around here, will forgive me for that.

Mr. Chairman and distinguished members of the committee, I appreciate the opportunity to appear before you today, and I want to commend you, Mr. Chairman, and your distinguished committee for moving forward on a problem which I think has literally reached crisis proportions.

Escalating insurance premiums or outright unavailability of some lines of insurance are having a devastating impact on many businesses, particularly small business. To help explore the extent of this problem in the small business community, some months ago I chaired field hearings of the Small Business Committee, as a matter of fact in the fall of last year.

Nearly all of the witnesses at that hearing believed that action was necessary at the State and the Federal levels to combat the crisis confronting them with regards to carrying commercial, liability insurance. Now, this message has been echoed in a series of small business conferences being held across the country. These conferences make it clear that skyrocketing insurance costs will be a priority issue at the White House conference on small business this August.

I want to commend the members of this committee for heeding these calls for action by pursuing legislative remedies to this problem. Legislation introduced this past Friday, S. 2129, I believe will provide some relief to the businesses who purchase commercial insurance. Amending the Risk Retention Act to make it easier for businesses and others to form risk retention groups makes good sense. Caught in what some would term a capacity crunch, businesses should have the option to establish risk retention groups on their own.

Now, while this legislation does not address all aspects of the present problems, I think it is an important first step. I agree with the sentiment expressed by the chairman that Congress should be doing everything we can to help purchasers of insurance help themselves. And I would ask that my name be added as a cosponsor to this legislation.

But as important as this and other legislative remedies are, one fact remains very clear. That is the relatively slow nature of the legislative process, something that I think every member of this distinguished committee is acutely aware of.

As we continue to debate legislative cures, small businessowners have to keep writing checks, and big checks, for insurance coverage, most of the time with decreased coverage. While we discuss the pros and cons of various proposals, the small business profits suffer.

In addition to legislative remedies presently under consideration, I believe that we need to take some immediate steps to curb these skyrocketing increases. As was pointed out in the earlier round of hearings on this subject, such a course of immediate action is available. As the members of this committee know, the McCarren-Ferguson Act provides property and casualty insurers with a general exemption from Federal antitrust laws.

However, under section 3(b) of the McCarren-Ferguson Act, boycotts and other activities remain subject to the prohibitions of the Sherman Antitrust Act. Case history suggests that policyholders are rarely successful in suits brought under 3(b). But several cases establish that the Government is a proper plaintiff in an action brought under section 3(b).

Many consumers, and indeed some in Congress, have suggested that the present problem with insurance availability amounts to an illegal boycott. Now, given these allegations—and I stress that at this stage they are purely that, allegations—the need for immediate action and the need for immediate action to combat the insurance crisis, I frankly question why the Department of Justice has not done more with this antitrust authority.

Indeed, I would urge the distinguished members of this committee to join me in calling on the Justice Department to expeditiously explore bringing actions under section 3(b) of the McCarren-Ferguson Act. Whether or not such an antitrust action ultimately proves successful, I do not know. But I believe it would send a strong message to small business and to insurers alike.

Small firms would know that their needs are not being ignored or neglected, and insurers would understand that, while the Congress searches for a long-term solution to this crisis, some restraint must be shown in ever-increasing insurance premiums.

Mr. Chairman, I want to thank you for this opportunity to appear before your committee this morning. I want to commend you for your efforts, and I look forward to working with you and the members of this committee in forming a solution to the insurance problems plaguing the Nation.

And before relinquishing the witness chair, Mr. Chairman, if I could just share with you and other members of the committee—and I am confident that my distinguished colleague is already aware of this factor—I did a little poll in my State, my State and Senator Gore's State, with regard to the impact of escalating insurance premiums on small business people.

It was a sample that included 416 small business persons. They reported that between 10 and 50 percent of the sample had had an increase in insurance premiums of 27 percent in the past year; 19 percent had had an increase of between 50 and 100 percent; 22 percent of the sample had had an increase in their premiums year to year of between 100 percent and 200 percent.

They were then asked whether or not they had had difficulty in securing insurance; 11 percent said they had been denied liabilitiy insurance coverage altogether; 16 percent said their insurance coverage had been canceled by their previous carrier; 21 percent said their insurance had been decreased, so almost 50 percent of the sample had either been denied insurance or insurance had been canceled or their insurance coverage had been decreased.

How do they respond to this? Ten percent said they were considering going out of business. Ten percent said they were staying in business but they would have to forgo commercial insurance coverage. In other words, they were going bare; 41 percent said, I am staying in business but will have to cut back on my level of insurance coverage. Of course, the overwhelming majority said, I am passing on the cost of increased coverage to my customers. A large percent also said, I am experiencing reduced profits because of increased liability cost.

And, last, I think this might be of particular interest to the committee. When they were asked whether the Federal Government should undertake any immediate investigation of increases in commercial liability insurance rates to determine whether increases in rates had violated Federal antitrust laws, 50 percent said the Federal Government should undertake such an investigation.

On 24 percent, they said the civil justice system should be reformed; 8 percent said uniform product liability needs to be enacted, and 12 percent said we don't need Federal intervention, let the market take care of the situation. I thought those statistics might be illuminating and interesting to the committee.

Mr. Chairman, I want to thank you and the distinguished ranking member for allowing me to appear here this morning.

The CHAIRMAN. Thank you, Senator Sasser. I very much appreciate that survey information. Is that it? Or is there more information from your survey that you could make available?

Senator SASSER. That is the survey information that I think would be pertinent, and I would be delighted to furnish that to each individual member if you would like.

The CHAIRMAN. Thank you very much. Any questions of Senator Sasser?

Senator HOLLINGS. I thank the distinguished Senator. You have obviously given a lot of thought to the idea that the Justice Department would move under section 3(b). I would hope, like you, Senator, that they would, because we are having this series of hearings. I can see what is going to occur now. We will debate the issues. We will report something out perhaps. But the crisis will still continue to the possible extinction of small business, and of course there might not be a Small Business Administration by August at the rate the administration goes. It recommends redlining the Small Business Administration, just getting rid of it entirely.

So we have got a difficult problem. But I appreciate your highlighting it here this morning, and that particular approach sounds valid to me.

The CHAIRMAN. Anything further?

Senator PRESSLER. Yes.

Senator GORE. He was first.

The CHAIRMAN. You were here first.

Senator GORE. I just wanted to say, Mr. Chairman, that weeks ago when you began this series of hearings I noted in my opening statement that my senior Senator, Senator Sasser, had been demonstrating real leadership on this issue. I think his statement and survey results here today provide further evidence to that fact. I can tell you that the hearing he mentioned in Tennessee was well attended, and the business community in Tennessee in particular was extremely interested in seeing what would come out of this session of Congress. I hope this committee can provide the kind of results that my colleague is representing.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. I want to comment to my colleague and say I appreciate hearing the results of your survey. I also did a survey in my newsletter, and the findings I found were very similar to yours, although we had different questions. We received 600 responses from all sectors, and they showed a number of problems; 32 percent of the respondents indicated their liability insurance had been canceled in the last year; 84 percent saw their insurance premiums increasing last year; 34 percent of those who experienced premium hikes saw increases range from 100 percent to 500 percent. Motor carrier insurance was the most troublesome line; 22 percent said that they experienced difficulties with this type of insurance, while 18 percent demonstrate problems with the health care and medical insurance, professional health malpractice, 16 percent, directors and officers, 8 percent, and governmental insurance, 7 percent, were also major sources of hardship.

The problems with premium increases in policy cancellations were spread across many different lines. They ranged from 22 percent indicated problems with motor carrier insurance, 18 percent with health care and medical insurance, 16 percent indicated problems with professional insurance, 7 percent indicate problems with directors and officers' insurance, the same percentage with government insurance; 4 percent indicated problems with liquor liability insurance; 4 percent indicated problems with pollution and environmental insurance; 2 percent indicated problems with day care center insurance, and 19 percent indicated problems with various other lines of insurance. So, I commend you on your survey, and as I listen, the results you found were very similar from the data that a questionnaire I sent to my constituents in December indicated.

Now, I suppose more of the people who responded were having problems, granted, and this is not, this would be said not to be scientific, but it was very similar to your results, and I wanted to point that out and commend you and hope that your survey is made a part of the record.

The CHAIRMAN. Senator Sasser, thank you very much. Incidentally, a boycott would indicate it has been a while since I have looked at any antitrust law, but would that involve a combination or conspiracy? There is no such thing as a one-company boycott, is there?

Senator SASSER. I wouldn't think so. It has been a long time since I have looked at that portion of the law myself.

The CHAIRMAN. But there is really a combined effort here?

Senator SASSER. Mr. Chairman, let me make it clear that I am not alleging that there is a combined effort. I am not alleging that the insurance companies would have liability under the boycott provision of McCarren-Ferguson. What I am saying is, given the present situation with regard to the explosion that has occurred in insurance premiums, that the Justice Department could use this section of the McCarren-Ferguson Act to open up the whole problem and make a thorough investigation.

Now, I appear here. I have had some experience in the insurance field in my other life. Frankly, I represented insurance companies for 15 years, so I have some idea of how they operate and how they operate within our present tort system, and I think there are a great number of reasons why insurance rates have exploded in the last few years. But I think it would be helpful and perhaps send a welcome message to some of the insurance carriers if the Justice Department would start looking into this matter.

The CHAIRMAN. Thank you very much, Senator.

Senator SASSER. Thank you.

The CHAIRMAN. Mr. Hazell, I want to thank you for your patience, but even more so for your willingness to be here this morning. You have traveled longer than some of us to get here this morning, and I do appreciate it. You came here from London, I believe?

STATEMENT OF RICHARD D. HAZELL—Resumed

Mr. HAZELL. That is right. I came yesterday.

The CHAIRMAN. Mr. Hazell, Senator Sasser is not the first witness to suggest bad acting on the part of the insurance industry. We had some days ago Ralph Nader, who is our most well-known consumer advocate, and he has undertaken something of a crusade against the insurance industry, and especially against Lloyd's of London, as a matter of fact. He claims that the problem is not the tort system, that we do not need tort reform, but rather the problem is that the insurance industry just is not making insurance available at a reasonable rate.

What Senator Sasser was talking about today was some sort of a combination in restraint of trade. Is that a plausible explanation as far as you are concerned? How would you respond to those arguments?

Mr. HAZELL. Well, I think the first thing I would say in answer to the Senator is that nobody enjoys running a business that loses money. That is not what we are paid to do. And of course somebody famous once said there are figures, statistics and damn lies, are there not, and with all due respect to the Senator's figures, it is true to say that if you have a $100 premium which is reduced to $50 you have a 50-percent reduction. If you then return to a $100 premium, you have a 100-percent increase.

It is a complaint we have had in the insurance industry for many years, sir, that the reductions we give are always percentages of the bigger figure, but the increases we ask for are always greater percentages of smaller figures. That is not to say that there are not some tremendous increases being asked for justifiably in many cases by insurers who need to recover the losses they are being called upon to pay.

The CHAIRMAN. Well, what is the reason for the present predicament? What we have seen is, I think, a marked change in a very short period of time. How would you explain that?

Mr. HAZELL. Can I give you what can only be considered to be a personal view? Because as an underwriter I can only explain my personal view. I have explained that Lloyd's is a collection of individuals. So let me try not to speak for the market, but to speak as an individual. I have been in the insurance business all my working life. And the period of time between 1978 and 1984 saw more people come into the insurance and the reinsurance industry than at any previous time.

If a reinsurance or insurance company is set up, the first thing it has to do is to write business, and therefore a lot of competition had been generated for virtually the same amount of business, and the net effect of that was that the business was being fought for by insurers who knew that they were able to reinsure it very cheaply, very often to leave themselves with a small profit for their own insurance operation.

Reinsurers around the world have been picking up the tab for these insurance losses for the past 4 to 5 years, and there has to come a time when even they will say enough is enough, and suddenly when you look at your balance sheet for the third or fourth consecutive year and you find you are still losing money, you say enough is enough, and as a businessman you then start to look at those areas of business that you have written where you are consistently losing money, and clearly, because you wish to have a right to stay in business and you wish to return a profit to one's shareholders or in my case members, then I look to those areas of business where I can predict with a degree of certainty what sort of results I can expect, and those are the types of business that I will look to write first.

Second, I will then look to those sort of areas where although not entirely predictable, the type of losses that may occur will be a catastrophe type of loss, not certain this year or next year, almost certainly there will be a major Californian quake, if you will. And I can make a book of that sort of business, but what I find the greatest difficulty doing is making a book of business where the policy wording I issue is not understood, it does not stand up, where the types of coverage I provided are leveled in another way from the way that I intended, and where the awards in court are enormous, and so I say as a businessman, sir, well, let us go one, two, three, in that order, and this, I believe, is why liability insurance is in the state it is in your country at the moment.

The CHAIRMAN. Now, there have been some well publicized disasters which have led to major insurance losses—plane crashes, satellites going out of service, and so forth. Is that part of the main problem?

Mr. HAZELL. With respect, sir, they do not fall on our liability account, planes going out of service or crashing fall on the aviation book of business at Lloyd's, as do the satellites, although in that last case satellites are intermarket, and can be written by marine, nonmarine, and aviation markets.

The CHAIRMAN. Senator Hollings.

Senator HOLLINGS. Well, you write those, do you not, Mr. Hazell. In other words, when you lose from the hurricanes, the airplane crashes, the different other events such as satellite losses, is that what you mean when you say enough is enough? A lot of that loss has occurred. Isn't that what we are saying?

Mr. HAZELL. That is not what I am saying, sir. What I am saying is that on those other types of losses I can look to the global accounts that we present to the world, and in those areas we still make profits, so we have got our numbers right there. We have been able to generate sufficient premiums to pay the normal expected run of losses and generate a catastrophe fund as well.

Senator HOLLINGS. So the losses that you have had from hurricanes and airplane crashes and satellite crashes have been normal as you see it now.

Mr. HAZELL. Yes, sir.

Senator HOLLINGS. What has been abnormal?

Mr. HAZELL. The abnormal problem that we face is the run of liability claims that we are being forced to look at. Forced is the wrong word. I apologize. I should withdraw that. Which we are having to look at where the court awards are outside anything we could have imagined when the business was written, very often 20 or 25 years ago.

Senator HOLLINGS. Unlike Senator Danforth, I wish you would have demanded that we come to London. I would love to be there for the hearing and gone to a good play tonight.

Let me ask you, how many times have you testified, Mr. Hazell, before the Congress? Is this your first time?

Mr. HAZELL. Yes.

Senator HOLLINGS. And at the other hearings over the United States, this is your first time to testify in this country?

Mr. HAZELL. It is my first time personally, but of course we have had representatives testify on our behalf.

Senator HOLLINGS. It seems strange that the liability or tort incidents of increased claims and awards as you have explained it seems to be the difficulty, but you have suggested you are not a tort lawyer and do not know anything about it.

Mr. HAZELL. Well, I am not a lawyer. I am an underwriter. And as I tried to explain in my statement, as a professional underwriter, the thing I need to have in my business is predictability, and I think what I am losing now in American casualty business is the predictability. I am not alone in this, sir.

Senator HOLLINGS. What change in the tort system do you discern that really has brought this increase in awards? What is the change in the tort system in America?

Mr. HAZELL. I do not think the tort system in America has changed, nor indeed would I plead for the tort system to be changed in your country. I think that would be presumptuous of me.

Senator HOLLINGS. You do not ask that we change the tort system. Very good. Excuse me. Continue.

Mr. HAZELL. What I am trying to explain to you, sir, as an underwriter, is the problems I face and the problems that the insurance industry by and large faced in writing American casualty business.

Senator HOLLINGS. And it is not the tort system, though. You are not asking that we change it.

Mr. HAZELL. No, sir.

Senator HOLLINGS. Thank you very much.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Mr. Hazell, you indicate that out of nine different accounts, eight of them are breaking even or making a profit, and then you indicate that the ninth, which is the worldwide general liability account, is suffering an overall net loss of $314 million——

Mr. HAZELL. Pounds.

Senator ROCKEFELLER [continuing]. Pounds, of which the vast majority was involved with the United States. Then you say that only 12 percent of Lloyd's total premium income was responsible for virtually 100 percent of your losses. That is a fairly stunning set of statistics.

Now, as a result of that, will there be certain kinds of insurance risks which Lloyd's either has ceased or is contemplating ceasing to underwrite?

Mr. HAZELL. As I hope to explain, sir, Lloyd's is not an insurance company. It is a marketplace, and there will always be a market for a commodity at the right price in Lloyd's. The right price may be the wrong price from the buyer's standpoint.

I do not think that the market will totally dry up in any class of business. I think there are always people there who will look to make a book of business in whatever the class is on the basis that they can do better than the last fellow.

Senator ROCKEFELLER. So you are not at this point contemplating any kind of cessation of particular types of enterprises——

Mr. HAZELL. No, sir. I think what we are doing, as I hope I have explained, is to look long and hard at what we do and how we do it.

Senator ROCKEFELLER. But you have used the word "lottery." A lottery is a high chance game, and I read into your careful selection of the word lottery a sense that there is something fundamentally wrong which will not preclude Lloyd's from being immune to that worry. Yet, you indicate to me that there will always be a market, there will be no change in the rules as far as Lloyd's is concerned.

Mr. HAZELL. There was a market, sir, but how large that market may be in the future is something I could not answer for you. Lloyd's has been a fairly strong supporter of American casualty business in the past few years, but the market today, as any Lloyd's broker would tell you, is very much smaller than it was 2 years ago, and I would predict it will be smaller yet this time next year, and I predict that on the basis that I think when our 1983 and 1984 results come through people will look at, and they may not withdraw from the class, but they will certainly reduce the commitment that they are prepared to give to that class of business.

Senator ROCKEFELLER. Let me follow with one further question. There are those who say that tort reform would solve a part of the problem, and there are others—for example risk managers, from Dallas, TX—who say that even if tort reform were in effect there would be no real reduction in the cost. Do you see a pattern on that, either worldwide or in this country? I realize you are neither an American nor a lawyer, and you may be hesitant to answer, but if there were tort reform, would there be any relationship in your view as an underwriter between what was offered and at what price?

Mr. HAZELL. I think I would come back to the word I used previously, which is predictability. If as an underwriter I can predict the outcome of something, I am much more relaxed about it, and I think the straight answer to your question would be, yes, if tort reform were to come about, and if that tort reform were to give underwriters a greater chance to predict what would happen to them given a certain set of circumtance, and to quantify the result of that action, the answer would be an unqualified yes.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Gore.

Senator GORE. Thank you, Mr. Chairman.

Mr. Hazell, in the first part of your statement, you describe the way Lloyd's functions as a market. I am a little unclear as to how the individuals within Lloyd's make decisions on which risks to accept and which to decline. Is there a set of standards? Is there an interchange of information about different categories of risk? Or is it totally an individual decision?

Mr. HAZELL. The decision is made on a syndicate by syndicate basis, and—can I take the time, Mr. Chairman, to explain a syndicate?

The CHAIRMAN. Sure.

Mr. HAZELL. A syndicate is a collection of individuals who are joined together in the same syndicate to underwrite a particular class of business. The syndicate will have somebody who is known as the active underwriter, who is, if you like, the chairman and chief executive and managing director of any other business, and he will then dictate underwriting policy for that particular syndicate. People join him because he has got that particular type of underwriting policy, and has produced that particular type of result over the past many years.

Senator **Gore**. Now, certain syndicates specialize in certain lines of business?

Mr. **Hazell**. Yes.

Senator **Gore**. All right. And is there any competition between syndicates for the same line of business?

Mr. **Hazell**. Oh, yes. Yes.

Senator **Gore**. But generally speaking, a syndicate will—and you have, what, 400 syndicates within Lloyd's. Is that correct?

Mr. **Hazell**. Yes.

Senator **Gore**. A syndicate will be known as a specialized carrier of reinsurance for a particular line of business.

Mr. **Hazell**. A syndicate is known by its number. We have numbers, a bit like convicts, perhaps, so that the brokers will know the number of the syndicate, and they will know that syndicate 190, which happens to be my syndicate, specializes in a particular area of business.

But can I just go on, so I do not leave you with the wrong impression?

Senator **Gore**. Yes, go ahead.

Mr. **Hazell**. Although we are specialized in one particular area, and lead in that particular class, at the same time we will support other specialists so that we broaden the base of our book of business.

Senator **Gore**. Now, the average membership in a syndicate would be around 6,000 or 7,000?

Mr. **Hazell**. Sorry, average in what way?

Senator **Gore**. The average number of members of Lloyd's in a given syndicate.

Mr. **Hazell**. No, I don't think that one could actually answer the word or answer the question, what is the average number. We have syndicates with 100 members, and my syndicate has 3,680 members.

Senator **Gore**. Are there members of Lloyd's who do not belong to syndicates?

Mr. **Hazell**. No. Yes, I beg your pardon. Yes, there are. There are one or two people who are members of Lloyd's but not currently actively underwriting.

Senator **Gore**. All right. You have 28,500 individual members of Lloyd's belonging to 400 syndicates. Now, let us take an example—I am looking at the witness list here. Let us take the nurse midwives as an example. When their business came in how would it be routed to the proper syndicate?

Mr. **Hazell**. Well, the broker would know which part of the market he would go to to place that type of business, yes.

Senator **Gore**. Yes. More than one?

Mr. **Hazell**. More than one syndicate?

Senator **Gore**. Yes.

Mr. **Hazell**. Oh, yes. In fact, it is true to say that there rarely is a slip, which is the thing the broker uses to complete his business, to place his business. That is very, very rarely written 100 percent by one syndicate. There can be 30 or 40 syndicates needed to complete one piece of business.

Senator **Gore**. But is there typically a lead syndicate for a particular line of business?

Mr. HAZELL. There would be three or four recognized leads in a particular class of business, yes.

Senator GORE. Yes. Now, do the members of the syndicate regularly review lines of business to update the risk or decide whether or not to accept certain risks?

Mr. HAZELL. The members, the members being the underwriting name, is what you are saying.

Senator GORE. The underwriting name.

Mr. HAZELL. Yes.

Senator GORE. You said in your syndicate there are 3,000——

Mr. HAZELL. 3,680.

Senator GORE. Yes. What line does your syndicate specialize in?

Mr. HAZELL. We are a reinsurance syndicate.

Senator GORE. Of all different kinds?

Mr. HAZELL. The international reinsurance business, which includes America.

Senator GORE. Do you have meetings of your syndicates?

Mr. HAZELL. No, sir.

Senator GORE. You do not?

Mr. HAZELL. No, sir.

Senator GORE. How are decisions made about what lines of business your syndicate will accept?

Mr. HAZELL. The underwriting policy is dictated by the underwriter, but in my case I have seven other people who are my deputy underwriters, and they will write specializing in their own particular class of business. They will come to me on a regular basis, and I will look at the results of their underwriting on a regular basis, and between us we will determine the future.

Excuse me, sir. Might I have a glass of water, please?

Senator GORE. If I could ask just one more question, Mr. Chairman, I know my time is up, and we have a long witness list. Several witnesses have expressed concern about what they view as a concerted withdrawal from certain lines of business. If you have a lead syndicate in a particular line of business, or three or four lead syndicates in a particular line of business, then that seems to me to lend a little more credence to the concern earlier expressed, because it would take the decision of a very few people to strangle off the access to reinsurance for an entire line of the business.

Do you understand the concern I am expressing?

Mr. HAZELL. Yes, I do.

Senator GORE. Is it valid in your opinion?

Mr. HAZELL. I think you give us credit for a lot more strength than we have.

Senator GORE. More?

Mr. HAZELL. More strength than we have.

Senator GORE. Everybody else says you have that strength.

Mr. HAZELL. I am very flattered by it, sir, but I do not really think it is fair.

As I said in my statement, we are quite a small part of the market. We believe that we had actually led the market, the worldwide insurance market, in a number of areas. If I could pick up one point specifically, there was some years ago in this country, what was known as an insurance or capacity crunch in the malpractice area. Lloyd's actually generated a reinsurance market for malpractice at that particular point in time which is still operative. I think it is true to say we have made money at it, too, but that is actually what we are paid for.

Senator GORE. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Pressler.

Senator PRESSLER. Thank you very much. Well, first of all, welcome here, and I am glad that Lloyd's of London is testifying. I think you should do more of it, because you are in many ways—you have a worldwide view. I had a chat with former Senator Pearson recently, who, I think, worked with you in some capacity, and urged that Lloyd's begin to testify frequently, because, I think, you might be able to shed some light on this.

There is one area that confuses me, and I would direct this question to you in your global report and accounts, 1984. Under your chairman's statement, Mr. Peter Miller talks about the various divisions, some of which are doing better and some of which are doing poorer.

He said while the marine account is the best for some years and four of the other six major accounts show a reasonable profit. The general nonmarine liability account shows an enormous loss. And I see in the nonmarine page that you are the chairman of that division that has the largest loss. Were you sent here for that reason?

Mr. HAZELL. No, sir. I was chairman, and I have to say that it was my privilege, but that is not the right word, to have to announce the worst nonmarine results that Lloyd's had ever had last year.

Senator PRESSLER. But if other division presidents were sitting here, they would show improvements, would they not?

Mr. HAZELL. Yes, sir.

Senator PRESSLER. I think that is an important point.

Now, in your written statement, you state that much of the blame for these poor results can be attributed to the need for underwriters to increase reserves for outstanding losses in the light of the more liberal attitudes adopted by American courts, very often in pursuit of the deep pocket theory. You have a worldwide view of this. I understand that in Ontario, Canada, they have changed their tort structure substantially, but there has been no variation in rates by Lloyd's of London. Is that correct?

Mr. HAZELL. I cannot answer that, sir, because the Lloyd's Canadian book in Ontario is very largely a motor account, a motor liability account which I do not participate in, but I would submit to you that the policy limits that are written there for motor business are, relatively speaking, quite small, and the premium volume was always big. Now, you get a good balance between the maximum policy limit and the premium base. So I do not think that that has become unbalanced yet. It may well be that those underwriters who are writing it are watching it very closely. That change, I think, sir, was a relatively recent one. It may not have had an effect yet.

Senator PRESSLER. Yes. If you could submit, if you could obtain from one of your other divisions some comparsions on that, it would be very useful for the record of this hearing. But aside from the specifics of that, we are told that Ontario, Canada, is experiencing the same insurance shortages and premium increases as in the

United States, despite the fact that Ontario already has in place many of the tort reforms the insurance industry is seeking.

It was also pointed out that in Europe, where many of these reforms or policy are also in effect, policyholders are not experiencing these disruptions in the insurance market. Could you provide us with a brief comparative analysis of your experiences in the United States, Canada, and Europe?

Mr. **Hazell**. I would not like to recall them as I sit here, but I am certainly prepared to submit them in evidence, if I may.

Senator **Pressler**. Yes, I think that is important, because as we sit here we are told different things in this committee. We are told by some that the insurance companies have made bad investments in the late 1970's and the early eighties, and the part of the fault lies there, but most of the time we are told by the insurance industry that the fault lies with our tort system.

Now, from your point of view, and you said in your statement, what can we change about our tort system that would get the rates down?

Mr. **Hazell**. Sir, I have already answered the question, I think, that I do not believe it is part of my bailiwick to sit here and advise you how to change your tort system. As I understand my job here, as I see it, I am trying to tell you the problems I face as an underwriter, and the problem I face as an underwriter, and I come back to the word again, is "predictability."

I cannot reasonably predict the outcome of any particular set of circumstances, and that makes underwriting very difficult.

Senator **Pressler**. But the thing I am getting at is, Ontario has had this extensive tort reform but the rates have not changed. I am told there is a standard rate for North America, so I guess that is the reason given, but there does not seem to be any reward for reforming or for changing the tort system.

Mr. **Hazell**. Well, again, I cannot answer your question, sir, because I do not know about the Ontario liability, but I will undertake to come back.

Senator **Pressler**. You may submit that for the record if that is agreeable. I would very much like to see that.

Let me ask you this. Reinsurers apparently suffered even greater losses in 1984 than the primary insurance industry. To what extent did the flood of reinsurers into the market prior to 1984 and the resulting low reinsurance prices contribute to those results? Do those results suggest any need for stricter regulation of entry into the reinsurance market in the United States?

Mr. **Hazell**. The answer to the first part of the question, a hundred percent, that it is as the result of a rapidly expanding market in the reinsurance industry. It provides cheap insurance that generates losses. That has been one of the facts of underwriters' life, I suppose, since like forever. As far as regulation is concerned, I would have thought not, because, I think, the great thing about the reinsurance business is that it is international, and if I could say by way of description of that, that insurance at basics is where the loss of one is shared amongst the many, and reinsurance at basics is where the loss of one insurance industry from one country is shared worldwide. It allows the catastrophe loss or the loss from any particular part of the world to be syphoned around the world and to be rescheduled, releveled.

That is international reinsurance at its best. And I would point out, sir, that the American reinsurance market itself is a strong reinsurer of other countries' business. And, in fact, some of my syndicates' reinsurances are actually written here in the United States.

Senator **Pressler**. Well, I might just ask one final question, Mr. Chairman. Then I have several questions for the record. The insurance industry has early been accused of being part of the problem by—it is so cyclical, and so many people enter the reinsurance thing, and then they drop out, and so forth. What steps could we take to smooth out these historical cycles from an insurance point of view? And obviously that is a part of the problem.

Mr. **Hazell**. I do not know that there is an easy answer to that, sir. I mean, if I really knew that one, I would probably become a consultant and not an underwriter.

I do not really think regulation and legislation is the answer. I think that underwriters do silly things. They broaden their policy wordings. They cheapen their rates. They pass the benefits that they are getting from high interest rates, if you will, down to policyholders. But the policyholder at the other end is the fellow who always receives the 50-percent premium reduction and the 100-percent premium increase, and that is a statistic that we quote amongst ourselves very often.

Mr. **Pressler**. Thank you, Mr. Chairman. I have several other questions for the record, and I look forward to your written response, especially on the Ontario situation, where they have had tort reform, and the rates have not gone down, and on the European comparative thing, because our insurance rates for average people in this country have really gone very, very high, and, I think, your company, Lloyd's of London, would be able to shed considerable light to lead us to a path of some solution.

The **Chairman**. Senator Gorton.

Senator **Gorton**. Thank you, Mr. Chairman.

When you refer your formal testimony to the immense losses in your liability business and also again on the size of that business on the last page of your testimony, I gather from your answers to Senator Pressler that your definition of liability insurance does not include personal policies for automobile liability?

Mr. **Hazell**. That is right, sir. That would come under the motor account.

Senator **Gorton**. OK, that is a different subject.

Mr. **Hazell**. Yes.

Senator **Gorton**. So would this be all other forms of liability insurance?

Mr. **Hazell**. Yes, sir.

Senator **Gorton**. Can you tell us whether or not there is a division in the profitability or the attractiveness of various forms of liability insurance? You seem to indicate in this excellent global report and accounts of 1984 publication which you have given us a particular concern for asbestosis, pharmaceutical products, and perhaps environmental litigation.

Is the primary focus or the primary source of the heavy losses to which you testify here in those areas against the more traditional form of product liability, say, for the manufacturer of machinery or the like? Or do those losses, those huge losses in comparison with premiums go all across the board?

Mr. HAZELL. I think in my account, and I can only speak for the account I write as a syndicate, our experience has been relatively narrow from the standpoint that they come to manufacturers, major manufacturers, major insureds, major industrial commercial companies are those that seem to attract the large award.

Senator GORTON. So it is more the size of the defendant, the size of the insured, the apparent deep pockets of the insured as against the——

Mr. HAZELL. My personal view is, it is very often the size of the insurance policy that he bought that attracts the award.

Senator GORTON. I see. That is a more important factor in your view than the particular subject matter, whether it is environmental, pharmaceutical, or otherwise?

Mr. HAZELL. Well, no, because as an underwriter, again, I look at each class of business as a class of business with a determination at the beginning of the year to make a profit from each.

Senator GORTON. Do you class differently, and are you beginning to become concerned about what now for the time being, at least, holds the record in this connection, the judgment which Penzoil has secured against Texaco? Would that fall into this liability category, the category we are discussing here?

Mr. HAZELL. No, it would not, but that sort of judgment would worry me.

Senator GORTON. Assuming that that kind of action on the part of boards of directors were insured or insured high, what category of your insurance would that fall into as against this liability——

Mr. HAZELL. The thing that must be classified, and again, I speak as a laymen, not a lawyer, but that would be classified as directors and officers.

Senator GORTON. I am sorry. I missed that.

Mr. HAZELL. Directors and officers. Sorry, sir.

Senator GORTON. OK, and at least up until this point, you have not—Lloyd's has not been suffering losses on directors and officers?

Mr. HAZELL. I make the point in my statement that there is a book of business that I know of in Lloyd's that has never bettered the 200-percent loss ratio.

Senator GORTON. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Trible.

Senator TRIBLE. I have no questions. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Kasten.

Senator KASTEN. Mr. Chairman, thank you.

I got here late, but I know that you have described the difficulties of people getting insurance. Do you think it therefore makes sense to work on efforts that would allow companies to group together and to form self-insurance groups—to form groups independent of the insurance groups to try to work on ways that individual companies can start to minimize the risk or I should say maybe maximize the opportunities to minimize the risk of self-insurance?

Mr. HAZELL. Yes, I do. I think—in fact, that has already happened in the past, has it not, and they are classified now as mutual companies. That is the way mutual started many years ago when insurance was unavailable and therefore the farmers gathered together and formed a mutual. It happened both here, as I understand it, and in Europe.

Senator KASTEN. Mr. Chairman, I have got a couple of questions for the next witness, but I have no further questions of this witness. I thank you very much.

The CHAIRMAN. Senator Exon.

Senator EXON. Mr. Chairman, thank you very much. One quick question. Lloyd's of London is an international company. Let me ask you this question. You are familiar, I can tell, with this critical situation we have here. It this unique to the United States, or have you had either product liability or professional liability difficulties in other countries as well?

Mr. HAZELL. I think the—I don't think it has been quite so severe in other parts of the world, but one has to recognize that in other countries there has been an insurance shortage for one particular type of cover or another at a particular time. I am thinking particularly of some years ago in France where it was impossible to get storm cover as a result of some fairly dramatic storms which took place over a short period of time, and the insurance industry sat back to regather its forces and think its policy through again. Storm cover now in France is freely available.

Senator EXON. Let us take the European countries, which are probably more like our economies than any others. Have there been significant increases in the premium for product liability or professional liability generally in the European countries?

Mr. HAZELL. Yes, sir. If I can elaborate on that answer a little, in the United Kingdom both have happened. The capacity has shrunk, has reduced very often by 50 percent, and the price that we now get for a product is 500 percent.

Senator EXON. 500 percent more as compared with what year?

Mr. HAZELL. As compared with last year, 1984 into 1985.

Senator EXON. Thank you very much. No further questions.

The CHAIRMAN. Mr. Hazell, I have just one question to clarify what you said to some of the other Senators. You have made it clear that you do not want to ask for changes in American tort law. Is the reason for that that you think that the present status, the state of American tort law, is just fine, and it is in an ideal condition now, and we should not be tampering with it? Or is it your view that you have a certain reticence based on the fact that you have flown in from London and you are not a laywer and you do not want to give us——

Mr. HAZELL. I said in answer to the question, I think, sir, that I honestly think that would be presumptuous of me to try and tell you how to change your tort law system. That does not actually mean that I am comfortable with your tort law system as an underwriter.

The CHAIRMAN. If we changed it, it would not irritate you?

Mr. HAZELL. Not at all, sir. Not at all.

The CHAIRMAN. Senator Exon says it depends on how you change it.

So one view is, we have got no place to go but up.

Mr. Hazell, thank you very much.

Senator **Pressler**. Mr. Chairman, I have one more very brief question, if I may. You did say you would respond on the record, but in your opening statement you say that you accept or decline risks shown to you in the United States and elsewhere on a daily basis based on your experiences on a daily basis. Why are the rates in Europe so much lower than they are in the United States?

Mr. **Hazell**. Because the record in Europe is so much better than I have on my book of American business.

Senator **Pressler**. That was what I was looking for, and you will bring us some statistics on that.

Mr. **Hazell**. Yes, I will.

The **Chairman**. Mr. Hazell, thank you. Thank you for coming here, and for your patience, and testifying, for your willingness to answer further questions in writing. You have been very helpful.

Mr. **Hazell**. Thank you very much, gentlemen. Thank you.

The **Chairman**. Now, the next witness is Mr. Jeffrey Bragg, the administrator of the Federal Insurance Administration.

[The following information was subsequently received for the record:]

F.R. White & Others,
London, April 2, 1986.

Senator John C. Danforth,
Chairman, Senate Committee on Commerce, Science, and Transportation,
Washington, DC.

Dear Senator Danforth: Thank you for your letter of the 10th March, 1986, enclosing supplementary questions which Senator Pressler had raised. First of all, let me apologize for not having replied sooner, the delay being caused by a number of other problems which have been taking a certain amount of my time. What I will do if I may is to reply to Senator Pressler's questions in the same order as they have been raised on the paper accompanying your letter. Before beginning, however, let me re-emphasize the point I made to you during the course of the evidence I gave in Washington, that is to say that my comments should be treated as those of an "Active Underwriter" and it should be remembered that these are generated by me as a result of my participation in American liability business.

It is impossible to answer with any degree of certainty the first question that has been raised by Senator Pressler. There is undoubtedly much more of a reluctance now to write American liability business than there has been over many years past. This is brought about by the feeling that one as an insurer does not get a fair crack of the whip, so to speak, in an American Court when attempting to defend against an insurance claim. There is a considerable body of opinion in this market, and I believe also in others, which feels that the plaintiff's lawyers are given a degree of license which is denied the defendant's legal representative.

As regards the second point of this question, I regret to say that such evidence cannot be supplied. If I may, I would remind you of the point that I made during the course of my previous evidence, which is the fact that Syndicates at Lloyd's trade as individual and totally separate entities and it would need the evidence submitted from each Syndicate's Underwriter to effectively provide the answer to this part of the question.

I believe it is true to say that Lloyd's American business is largely excess liability coverage rather than primary business. This is not surprising as Lloyd's itself is too far removed from America to successfully trade as a primary liability insurer. The needs of the insured cannot be serviced by an insurer based at least 3,000 miles away and by and large Lloyd's Underwriters do not have any sort of network system capable of handling such service requirements on their behalf.

As a reinsurer Lloyd's does not in my view attempt to dictate what primary insurers may or may not do. What would happen, of course, is that, if in the view of the Lloyd's Underwriter the primary carriers terms and conditions do not look capable of being commercially viable, that is to say producing an end profit, then Lloyd's will either decline to participate in the reinsurance or will load the reinsurance premium to compensate for the uneconomic premium that it is their view is being charged.

I do not think that I could advise you in any way as to what the insurance industry should do to level out the cyclical nature of its business. The simple answer would be to make insurance produce a profit without the benefit of what is commonly known as investment income. In this way professional insurers minds would be concentrated on the primary task that they have which is to make money from issuing insurance policies and the settling of claims.

I believe that you will by the time you receive this letter already have had additional evidence submitted as far as Question 4 is concerned, that being from Lloyd's General Counsel in America, Messrs. LeBoeuf, Lamb, Leiby and Macrae. If this is not the case or if the evidence you have received is not satisfactory, then please do not hesitate to ask again and I will endeavour to elaborate where necessary.

I believe the fair answer to Question 5 on Senator Pressler's Paper would in a word be severity. Can I tell you by way of explanation that there has recently been a case in Illinois where the plaintiff has received an Award of $13,000,000. To this has been added a punitive damage claim of $26,000,000, so that the total damages awarded to the plaintiff now equal $39,000,000. I hope you will believe me when I say that no insurer anywhere in the world can reasonably underwrite against the risk of a single person claim costing his insured $39,000,000. Indeed, I hope you will also believe me when I tell you that the premium which will need to be charged to provide for that sort of Award, should it become commonplace, will make today's prices look very small by comparison. I hesitate to send you details of that particular case as I am not certain whether that would conflict with your position as Chairman of the Committee. If it would not, however, and you would like to see how such a situation has developed, I would be more than happy to send the complete file for your review.

In a similar way, if there is any more information which I can provide or indeed any elaboration of the points I have already made in this letter, I shall be more than pleased to help.

Yours sincerely,

R.D. HAZELL.

LEBOEUF, LAMB, LEIBY & MACRAE,
Washington, DC, March 3, 1986.

Hon. JOHN C. DANFORTH,
U.S. Senate,
Washington, DC.

DEAR SENATOR DANFORTH: Our firm serves as United States General Counsel to Underwriters at Lloyd's, London. Tomorrow a representative of Underwriters will be testifying before you and the Senate Commerce Committee. This witness, Richard D. Hazell, is a Member of the Council of Lloyd's, and leads an underwriting syndicate at Lloyd's.

Senator Stevens and Mr. Hazell have asked us to request that you enter on the record the fact that Senator Stevens is a Name at Lloyd's and includes Mr. Hazell's syndicate among his syndicate memberships. Senator Stevens is one of approximately 3,580 Names for whom Mr. Hazell underwrites.

Very truly yours,

CHARLES W. HAVENS III.

The CHAIRMAN. We have a number of witnesses to go and it's already 11 o'clock, nearly 11 o'clock. So I would ask the witnesses to attempt to abide by the time limit. All written statements will be included in the record in full automatically, so you do not have to take any of your time asking for your statements to be included in the record. Your statement will be included in the record.

Mr. Bragg, thank you very much for being here.

STATEMENT OF JEFFREY S. BRAGG, ADMINISTRATOR, FEDERAL INSURANCE ADMINISTRATION, FEMA

Mr. BRAGG. Thank you, Mr. Chairman.

I appreciate the opportunity to be here and to testify before you today. I think these hearings address critical issues that are facing the insurance industry and citizens throughout the Nation.

At the outset, let me emphasize that the Federal Insurance Administration is an administrative agency and not a regulatory agency. The Congress has very wisely left to the States and their departments of insurance the basic responsibility for overseeing the business of insurance.

Mr. Chairman, my statement reflects several key premises. First, that there is not now a need to have comprehensive Federal legislation or to initiate any new Federal program or regulatory scheme to oversee the insurance industry. In particular, I would not recommend that a Federal reinsurance program is necessary or desirable.

Second, that solutions can and should be achieved at the State level by cooperative working relationships between public and industry officials. In fact, these relationships are already being established in many jurisdictions with early resolutions in several areas that deserve further exploration and implementation.

Third, that the insurance industry must be encouraged to focus attention on risk reduction and management with less reliance on investments and sales as its principal means of keeping receipts ahead of losses.

And, finally, that attention is needed to resolve problems that have arisen from highly inflated recoveries in negligence cases in a number of jurisdictions.

The insurance industry is today being criticized, with some justification, I believe, because premium increases over the past 2 years have had a great impact upon the consumer. Much of this is due to escalating risk and the recent drop in interest rates.

In past years, low premiums could be recovered by high investment recovery. There is, however, an irony to some of the criticism. Critics of today's higher premiums were not until recently critics of the lower rates in the years past. Seemingly, they ignore the fact that rate undercutting on premiums demonstrate a lively degree of competition which these same critics insist in other contexts does not exist in the insurance industry.

In addition, insurance commissioners are being blamed for not controlling today's high premiums; but in hindsight, they are also being blamed for permitting the lower premiums of the past. Had the insurance industry collected high premiums and high interest rates during these earlier years, one can imagine the outrage that would have been expressed toward the insurers as well as the insurance commissioners.

Being critical of the insurance industry for taking advantage of high interest rates and giving the insurers a bargain is somewhat unrealistic in terms of the real world in which we live. However, there is some evidence that the industry did let its attention be diverted by high investment return away from one of its most important principles, namely, loss reduction and prevention.

In its pursuit of capital return and sales, some insurers paid little attention to the underwriting differences between various insureds. This has come back to haunt them when escalated losses led to decisions to restrict the business they underwrite.

And now real economic penalties are being imposed by a free enterprise system on insurers who ignored basic tenents of their business. As we start to seek solutions, one thing we must do is to put behind us the notion that the Federal Government has access to sources of wisdom that escape the State level. Several States are working toward new avenues of insurance availabiity. Florida is investigating the possibility of forming assigned risk pools for various property casualty lines.

California has worked with a group of underwriters to develop a statewide program to provide liability insurance for day care centers. The commissioner of insurance for New Jersey was also successful in obtaining day care center liability coverage and in addition was able to find companies to write liability insurance for taverns and restaurants.

The superintendent of insurance for New York has asked the State legislature to consider expanding the State insurance fund to write property casualty insurance from municipalities and businesses. I could go on and on, but with the States of Pennsylvania, Montana, and many of the other States represented at your hearing today, I will forgo those examples and simply ask you to remember that much is being done at the State level to attempt to solve this problem.

Meanwhile, several industry groups have begun either forming insurance companies or self-insurance pools and basing the contributions of the members upon the risk factors relevant to their particular business.

Thirty-three American companies have contributed a total of nearly $300 million to set up their own insurance company. The banking industry is forming its own insurance company to obtain insurance for directors and officers liability.

A recent article in the National Underwriter quoted the president of one of the largest insurance brokerage firms in the world as saying that a severe shortage of casualty business, coupled with premium rates could push as much as one-third of the premiums usually earmarked for insurance companies into self-insurance reserves, wholly owned insurance subsidiaries—captives—and pooling mechanisms. He further indicated that it was quite probable that those lost premiums might not return to the traditional market.

These initiatives exemplify actions being taken by a highly competitive industry. In my view, this demonstrates the strength of the industry and confirms assurances we can all have that a free enterprise market can and will make necessary adjustments.

Mr. CHAIRMAN. I do share the concerns that many have expressed about the challenges facing the insurance business as a whole that have come about by recent court holdings on liability. Historically, the degree of responsibility between parties basically has turned on questions of relationships between the parties, duties to protect, a breach of some duty, and losses suffered.

While these legal axioms remain important, recent outcomes of litigation in some areas show a shift on liability decisions away from these traditional precedents and more toward a simple determination of ability to pay.

In these situations, the result is tantamount to absolute liability for the defendant business or State and local government and ultimately it's insured.

The CHAIRMAN. Can you wind it up?

Mr. BRAGG. In summary——

The CHAIRMAN. Thank you.

Mr. **Bragg** [continuing]. I believe that the competitive insurance market in our Nation is cyclical and has proven quite resilient in responding to social and philosophical swings in our society.

Clearly, the insurance industry has grown stronger, more competitive and better able to serve the consumer by overcoming marketing and risk challenges like those with which we are confronted.

Here the competitive free enterprise characteristics of the industry are best proven as new competitors see opportunity to market coverage at better rates. This, in turn, pressures the existing market to find acceptable results or face the loss of their business altogether.

Senator, I appreciate the opportunity to testify. I do need to tell you that these are my personal views and do not reflect necessarily the philosophy of the administration.

The **Chairman**. Mr. Bragg, thank you very much. You have stated your confidence in the States and—basically—in the industry. Does this mean should we just fold our tents here in Congress or is it worthwhile pursuing both tort reform and an expansion of the Risk Retention Act?

Mr. **Bragg**. No. I do believe that exploring changes in the Risk Retention Act is valuable. Personally, I support that legislation. I would also suggest that the committee should explore, in detail, the kinds of things I have suggested—to certify that they are accurate. And I certainly would encourage you to do that.

But I think, on full examination, you will see that much is being done in the private sector and at the State level.

The **Chairman**. So with respect to tort reform with respect to an alternative claim system, you are, what would you say, lukewarm or ice cold?

Mr. **Bragg**. I would say with respect to tort reform, that that is primarily, in my opinion, where the committee should focus its attention. I do note, however, that some 22 States are considering some form of tort reform legislation and that much activity is being done there, too, and I certainly wouldn't want the committee to take any action to preempt that kind of opportunity at the State level.

The **Chairman**. Senator Rockefeller.

Senator **Rockefeller**. Just one question, Mr. Chairman.

Mr. Bragg, in your statement, you said that there are some types of Federal reinsurance that may be necessary. Can you foresee any Federal Government participation in the municipal reinsurance area?

Mr. **Bragg**. Not at this time, Senator. I think the point of the long version of my testimony is that there may be a need for some property insurance programs where, like the National Flood Insurance Program, for example, there is a long history of coverage not being available in the private market. It was for that reason that the National Flood Insurance Program was created and there may be a need for some consideration to be given to the earthquake insurance issue, for example, where there is an incredibly limited amount of coverage in the private sector for earthquake protection.

But I do not see a need for a reinsurance mechanism at this time for any liability coverages simply because those coverages were available in the private market and I believe that they will be offered again either by the traditional insurers or by others who will be entering the market. I would not want the Federal Government to preempt that private sector initiative by creating a Federal reinsurance program.

Senator **Rockefeller**. Thank you.

The **Chairman**. Senator Exon

Senator **Exon**. Mr. Chairman, thank you for very much.

Just one question, Mr. Bragg. You did not say so in your oral testimony, at least that part that I heard; it may be covered in your written testimony.

I take it that you are not in support of any change in the McCarren-Ferguson Act?

Mr. **Bragg**. That is correct, sir.

Senator **Exon**. Thank you.

The **Chairman**. Senator Kasten.

Senator **Kasten**. Thank you.

First of all, I would like to follow up on what Senator Rockefeller said and what you said also, Mr. Chairman. I think we have once more demonstrated that it is possible to bring together a coalition on issues related to product liability and to the overall insurance question and I am pleased that we were able, on a bipartisan basis, to come forward with S. 2129 the Risk Retention Amendments of 1986, legislation introduced last Friday, as the Senator from West Virginia mentioned.

We have got strong, bipartisan support and I think that with the statements that I know are coming from others in the panel, we have got strong support for our efforts overall, going way beyond Washington. It will make it easier for businesses, for associations, for professionals, for municipalities, for other organizations to form collective purchasing groups and self-insurance groups for general liability coverage.

We began this effort in 1981 with the Risk Retention Act Amendments and now we are going forward with another set of amendments. And I am pleased that we have got this kind of support. But I think it is clear, as you said, that tort reform was top of your list.

This legislation is not a panacea; it is not cure-all for the current liability insurance crisis. But this expansion of the Risk Retention Act would provide some immediate relief to some of the people that are affected by the unavailability and the high cost of liability insurance.

I am hopeful, Mr. Chairman, that we are going to go forward very quickly with hearings on S. 2129 and then go forward, pass the bill in the Senate, pass it in the House. And I would hope that we are talking about a matter of a very short period of time—possibly months before we move this bill all the way through. It does not necessarily mean we are going to be as as successful with the efforts that Senator Danforth, and others, and I have been making with S. 44, S. 100, or the most recent draft of product liability reform legislation, but we are going forward there, also. Now you we should be careful because a number of States arementioned working on product liability legislation. That is right. But in each one of those States the trial lawyers are actively lobbying against that legislation.

Just so it is on the record, you just nodded. But yes, you are aware of that?

Mr. **Bragg**. Absolutely.

Senator **Kasten**. Are you also aware that one of the parts of the trial lawyer's strategy is to make sure that no one State adopts exactly the same legislation that another State does. Uniformity is what we are trying for. Uniformity is what the Carter administration came out in favor of when they came out with the uniform product liability bill in 1978 or 1979, which we hoped would be adopted by each State. UPLA was set out as the model product liability bill and in fact it was rejected by each State. Some people adopted some kind of a bill.

But it is this patchwork of differences from one State to another that is causing a large amount of the lack of predictabiity that the gentlemen from Lloyds of London referred to and that all of us are concerned about.

Some of the State laws are working on reasonable statute of limitations. A number of the States are working on the particular problems of remodeling or retrofitting and the responsibilities of used machinery dealers as opposed to the original manufacturers.

But there is not one idea that is going all the way through, and the result is that even if the States do adopt something, it really does not solve our problem because we still do not have a uniform—in my opinion—a uniform national standard.

Are you saying that, in your opinion, a uniform, national standard is not important, or are you just saying that States are working on it and we should be aware of the work that they are doing?

Mr. **Bragg**. I guess, Senator, what I am saying is that, with respect to tort reform in general, I am not concerned that what the States do is of a uniform nature. I think it would be fine if the Congress of the United States were able to pass something that could grant relief to manufacturers and to insurers on a uniform basis, particularly with respect to tort reform in the product liability area, but I think that we have to work at all levels, including the State level, to make sure we get whatever reforms are available.

If the Congress is unable to act in this area, for example, I think we need to have State action, and that they differ on any number of issues may be a source of strength as well as weakness, because it will give us the experience we need in order to determine what needs to be done in the future.

So I guess I disagree with you just a little because, at least with respect to tort reform in general, I do not think that there is necessarily an advantage to uniformity.

Senator **Kasten**. Mr. Chairman, thank you.

The **Chairman**. Mr. Bragg, thank you very much.

[The statement follows:]

STATEMENT OF JEFFREY S. BRAGG, ADMINISTRATOR, FEDERAL INSURANCE ADMINISTRATION, FEDERAL EMERGENCY MANAGEMENT AGENCY

I wish to thank the Committee for inviting me to testify this morning. Certainly, these hearings are on a topic that is of great importance to our Nation.

At the outset, let me emphasize that the Federal Insurance Administration (FIA) of the Federal Emergency Management Agency (FEMA) is an administrative agency and not a regulatory agency. The Congress has very wisely left to the States and their Departments of Insurance the basic responsibility for overseeing the business of insurance. I am convinced that the public continues to be best served by a system that reflects the needs of the citizens of the various States. While my office may have been perceived in the past as stretching the scope of its activity beyond statutory missions, I am committed to the task of devoting our resources to the specific goals entrusted to us by the Congress. These statutory responsibilities are to administer the National Flood Insurance Program (NFIP) and the Federal Crime Insurance Program (FCIP).

My background is in insurance, and I believe very strongly that the insurance needs of the public can be best met by the private insurance sector, operating in a highly competitive marketplace. I am concerned about the problems which face the insurance industry and most importantly, the nation and appreciate your giving me the opportunity to be of assistance in your efforts to seek solutions.

A most obvious problem, from the public's standpoint is the recent rise in insurance premiums, especially in the commercial liability lines. Also, in some areas there is difficulty experienced by many organizations in obtaining insurance at any price.

From the standpoint of the insurers, much of the problem stems from the adverse experience of losses which have made 1983 and 1984 the worst years in insurance history. These "problems" are obviously interrelated and one cannot be addressed without giving consideration to the other.

It is important to recognize that a solution that "resolves" only one of the many problems faced by the public is no true solution. And, even more importantly, history shows that purported solutions which commit the funds of the Federal government end up with the taxpayers bearing the cost of the solution. If good risk management and a wise judicial climate are absent, the public will bear higher and higher costs, either as consumers or taxpayers. This is no solution.

Currently the insurance industry is being criticized, with some justification, I believe, because premium increases over the past two years have had a great impact upon the consumer. Part of this is due to escalating risks, but a large portion also reflects the drop in interest rates. In the past, low premium charges could be covered by good investment recovery.

But there is a certain irony in this criticism of the low premiums of previous years by the same critics of today's high premiums.

Seemingly, they ignore the fact that the undercutting of insurance premiums by insurers vying for the premium dollars demonstrates a lively degree of competition, which these same critics insist in other contexts does not exist in the insurance industry.

In addition, Insurance Commissioners are being blamed for not controlling today's high premiums. Again, these are the very same parties who are blamed for permitting the lower premiums in the past. Had the insurance industry collected high premiums as well as high interest income during these earlier years, one can imagine the outrage that would have been expressed toward the insurers as well as the Insurance Commissioners.

Simply to blame anyone for taking advantage of high interest rates and giving the insureds a temporary bargain is somewhat unrealistic in terms of the real world in which we live.

However, there is some basis for concern that the insurance industry did, in past years, let itself be diverted by the allure of higher investment return from what should be one of its most important principles, namely loss reduction and prevention. In its pursuit of premiums with which to obtain capital return and sales, insurers may have paid less attention to the underwriting differences between various insureds. In terms of higher loss expenses, this has come back to haunt them when their overall losses led to decisions that they must restrict the business they underwrite.

Criticism, justified in some circles, has come from those who feel that they have had their insurance either terminated, or renewed with extremely large premium increases, without any indication that their particular risk has been examined. And one can understand the concern that Insurance Commissioners have expressed when the desire to restrict business has resulted in midterm cancellations and restricted renewals. The industry must learn that it cannot rely simply on positive cash flow underwriting. And it cannot abandon solid risk underwriting criteria as it attempts to correct some of the past problems.

But I believe that some problems and adjustments were inevitable and even understandable, given the conditions that existed. If we are really to find a solution to today's problems, insurers, insureds, Insurance Departments and State officials must resist the temptation to point fingers and work together to identify the underlying problems.

I further believe that real economic penalties are being imposed by a free enterprise system on insurers who have ignored the basic tenants of their business and that we are going through some short-term cyclical changes.

But the focal point for our efforts to solve whatever problems do exist must be at the State level. We are putting behind us the notion that the Federal government has access to sources of wisdom that escape the local level. On the other hand, hearings such as these, provide a valuable and timely forum by which the problems arising at the State level can be compared.

Moreover, we all recognize that there may be some areas of potential loss which can so affect the national interest that Federal involvement becomes necessary. The history of the National Flood Insurance Program (NFIP) provides such an example.

Prior to 1968, the Federal government was constantly drawn into the catastrophe of flood losses through disaster relief. Without an insurance program, all losses tended to be covered by tax revenues and, in most cases losses of less than disaster proportions were not covered at all, except as a casualty tax write-off.

Generally, no private flood insurance had ever been available. Today, through sound insurance management and flood plain management requirements, that reduce the potential for flood losses, the NFIP has provided an insurance remedy for losses and reduced the potential drain upon taxpayer funds. There are other national catastrophe situations, such as earthquake, which may benefit from the application of some of the lessons of the NFIP through risk reduction and a private insurance approach, with a Federal government backup. But in terms of regulating insurance, there is no evidence that there would be any long-term benefit to the public in moving regulatory functions one level further away from those who need protection. We should not abandon solutions to availability problems offered by free enterprise and encouraged by State activity.

Several States are finding new ways of opening avenues to insurance availability. Florida is investigating the possibility of forming assigned risk pools for various property/casualty lines. The California Insurance Department has worked with a group of underwriters to develop a statewide program to provide liability insurance for day-care centers. The Commissioner of Insurance for New Jersey was also successful in obtaining day-care center liability coverage and in addition was able to find companies to write liability coverage for nurse midwives and liquor liability insurance for taverns and restaurants. The Superintendent of Insurance for New York has asked state legislators to consider expanding the State Insurance Fund to write property-casualty insurance for municipalities and businesses. The States of Pennsylvania and Montana are working to establish self-insurance pools in their States for municipal liability. These are just some examples of how the States are responding to the problems that have been presented to the Congress. While these are not necessarily final solutions, they provide temporary remedies, and Federal preemption would discourage further State initiatives.

Meanwhile, several industry groups have been either forming insurance companies or self-insurance pools and basing the contributions of the members upon the risk factors relevant to their particular business. Recently 33 major American companies contributed a total of nearly $300 million to set up their own insurance company. The banking industry is forming its own insurance company in order to obtain liability insurance for directors and officers.

An article in the National Underwriter quoted the president of one of the largest insurance brokerage firms in the world as saying that a severe shortage of casualty business, coupled with premium rates could push as much as one-third of the premiums usually earmarked for insurance companies into self-insurance reserves, wholly-owned insurance subsidiary (captives) and pooling mechanisms. He further indicated that it was quite probable that those lost premiums might not return to the traditional market.

These private sector initiatives, also, are not panaceas. But they do exemplify exploratory actions industry is taking to resolve its issues, not unlike steps taken when very many companies were just getting started. They are simply underwriting the risks with which they are familiar and sharing the potential for loss.

There is of necessity the possibility that these mechanisms may becomes so successful that the market they represent may never return to the regular insurance business. This should give insurers some cause for concern. It may be the type of penalty free enterprise extracts from the mistakes made by others. But even so, premature involvement by the Federal government might well preempt private sector solutions to problems faced by the insurance industry.

Also, the willingness of those outside of the insurance business to take on an insurance function from which the traditional insurance industry has retreated greatly weakens the argument advanced by some in the insurance industry that outsiders should be excluded from the area of insurance.

Clearly in some cases insurers took in business during the high interest days without scrutinizing underwriting factors and many are now expelling business with the same disregard for those factors. Their actions create a pressure to establish new sources of coverage which may take on a life of their own. The fact that when confronted with an insurance crisis, prospective buyers have been willing to develop new sources of coverage further demonstrates the benefit of allowing the market place to resolve its own problems whenever possible, rather than be lulled into creating a Federal solution in the form of increased regulations of direct participation in the insurance market.

If we have learned anything over the years, it is that business generally, and the insurance business specifically, is cyclical. If we can resist the temptation to interfere, free enterprise, in most instances, will prove to be the most effective and fair vehicle for change. We have seen this in the examples I have cited where new insurance mechanisms have emerged to fill the vacuum created by the insurance industry. Nevertheless, in the case of some of the most severe problems, it may be necessary for government to take action, especially for the protection of those who lack the resources to create new insurance mechanisms. But this should occur at the State level first, where we have seen there has been a significant response. It would be entirely premature for the Federal government to become involved so long as States are willing to meet the challenge.

One underlying problem which must be resolved is the growing belief that for every mishap a person suffers, there must be a financial remedy. The tort system that has developed from our common law heritage has depended upon the concept that where one person has acted wrongfully against another, the judicial system provides a remedy by imposing liability upon the person who is at fault and for enforcing payment to satisfy that liability. Certain kinds of injuries have been dealt with on a special basis, as in the case of inherently dangerous or hazardous activities. Various statutory provisions have created remedies such as Workers Compensation which provide for payment of work related injuries without a showing of fault.

But by and large, the American judicial system has been based on providing a potential financial remedy upon a finding of fault and proximate cause. The standard for determining the existence of fault utilized the doctrine of the reasonably prudent man, not the perfect man. Therefore even though a person's action might cause someone to be injured, he was not held financially liable if he acted in the same manner in which the reasonable prudent man would have acted. Moreover, under the doctrine of comparative negligence, a person who slipped only slightly below the standard comtemplated for the reasonably prudent man would be held liable only for an amount which reflected his proportionate liability, as compared to the greater degree of negligence which might be found with respect to the injured party.

Insurance became, of course, the mechanism for spreading and shifting the risk of becoming financially liable. And so long as the existence of insurance did not alter the standard of liability, the system worked well. But the very success of insurance in spreading risk and building up reserves to cover calamities has in some instances caused instability in the market.

I am referring to circumstances when the judicial system looks beyond the defendant as the person whose action is being weighed, but rather to the bank account of the insurance company or the treasury of a local municipality.

Simply stated, we have moved more and more toward strict liability without a need to establish fault as previously. And at the same time that the standards of liability have been stretched there has been a tendency for more generous damage awards.

Some may argue whether this has been a boon or a bane to society, but there is no doubt that it has inflicted costs. The cost of insurance premiums is directly related to these developments and as people and organizations, private and governmental, find the costs to be more than they can absorb, hard choices must be faced.

This is just part of the background of the debate for tort reform. Some examples of legislative actions that have been taken are the limitations adopted in California with respect to non-economic losses and limitations on contingency fees for attorneys. Other areas that have been proposed include limiting the concept of joint and several liability by which a party, whose liability has contributed as little as one percent of the injury, can end up shouldering the entire liability.

Overall, the whole concept of reasonableness and fault needs to be revisited. Ultimately, liability must be based on factors other than the presence of financial resources of an insurance company or a taxpayer-supported municipal government.

These are the critical underlying factors that must be considered. They force us to face the extent to which the insurance mechanism seems to be transforming genuinely unfortunate mishaps into chances for a once in a life time opportunity to obtain not only a payment commensurate with the injury, but in addition an acquisition of wealth and financial security in an otherwise uncertain world. Resolutions are not easily made that balance all the factors perfectly and it would be wrong if we were to overreact and undo many of the changes which have provided remedies that were truly needed. But we must balance the costs of these remedies and recognize that there are costs which ultimately will have to be borne by everyone.

In closing, I would again urge that this is not the right time for a Federal legislative solution. Insurance companies have for too long been viewed by many as a source of unlimited funds which could be paid out without seeming to cost anything to the average person. And now there are some who see the resources of the Federal government as temptingly available to provide the means of paying for a tort system that is becoming too expensive to fund through the premiums of insureds. If the Federal government is brought into the picture before the hard choices are made as to how to conduct our tort and reparations systems, we will only be shifting burdens to taxpayers and postponing the day of decision. There is no doubt that the solution of these problems is matter of concern at the Federal level, but the tools for the solution are largely at the State level, working in close concert with the industry.

I appreciate your giving me the opportunity to be with you today and I would be glad to answer any questions.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question. Do you feel there is any role for the Federal government in areas where private insurance is simply not available and will not be forthcoming in the near future?

Answer. Obviously, there are certain areas of insurance where private insurance is not available and probably will not be in the near future. The best example of this is flood insurance which, since 1968, has been provided by the Federal government. In this case, through sound insurance management and flood plain management requirements that reduce the potential for flood losses, the National Flood Insurance Program (NFIP) has provided an insurance remedy for losses and reduced the potential drain on taxpayers funds.

There are other national catastrophe situations, such as earthquake, which may benefit from the application of some of the lessons of the NFIP through risk reduction and a private insurance approach, with a Federal government back-up. Fundamentally, most aspects of insurance should remain at the state level. Nevertheless, in the case of some of the most severe problems, it may be necessary for the Federal government to take action.

Question. What steps can or should the insurance industry take to smooth out the historical cycles that appear to cause such dislocation in the economy?

Answer. In the past few years, the insurance industry let itself be diverted by the allure of higher investment return from what should be one of its most important principles, namely loss reduction and prevention. In its pursuit of premiums with which to obtain capital return and sales, insurers may have paid less attention to the underwriting differences between various insureds. By focusing its attention on sound underwriting principles and not overreacting to the problems at hand, industry can smooth out the cyclical swings that are now being experienced.

Question. Over the past twenty years the Federal government has developed several insurance and reinsurance programs, almost all of which has lost money.

Answer. Do you feel the Federal government could ever run an insurance or reinsurance program that would be self-supporting? If so, what would be the requirements of such a program?

One of the goals of the National Flood Insurance Program is to be self-supporting by 1988. This program had traditionally been viewed as a "give-away" with little emphasis on sound underwriting. For the past five years, we have attempted to improve the loss history of the program through a series of fundamental program changes. Rates have been increased to more accurately reflect the risk. Certain coverage changes have been made that more closely reflect the intent of our authorizing legislation. Through this process, our combined loss and expense ratio has been reduced from 2.64 to 1.24. Pending changes will bring the ratio to 1.0 for the average loss year.

Obviously, I do feel that a government insurance program can be self-supporting. The riot reinsurance program was self-supporting during its fifteen year history, amassing $124 million. The combined loss and expense ratio for the Federal Crime Insurance Program has been significantly reduced in ways similar to the flood insurance program. As I mentioned previously, we have every intention to making the flood insurance program self-supporting. To create a self-supporting program, the government must view it as an *insurance* program. Methods of loss reduction and prevention must be coupled with adequate premium charges. Neither of these alone is sufficient to make the program self-supporting for the long term.

The program also must be able to accurately predict losses. This is a part of the problem today with liability insurance. The uncertainties in the tort system make it extremely difficult to accurately forecast losses. While the flood insurance program has dramatic swings from year to year, average losses over the long term can be predicted. A self-supporting government insurance program is a possibility, and in fact, has been a reality. However, the temptation to solve an immediate problem by creating a Federal program should be avoided.

The CHAIRMAN. Next we have a panel. Josephine Driscoll, insurance commissioner of Oregon and president of the National Association of Insurance Commissioners; William Gunter, insurance commissioner of Florida; Bruce Foudree, insurance commissioner of Iowa; and Lawrence Thompson, chief economist of the General Accounting Office.

Ms. Driscoll, would you care to proceed?

STATEMENTS OF JOSEPHINE DRISCOLL, INSURANCE COMMISSIONER, STATE OF OREGON; WILLIAM D. GUNTER, COMMISSIONER, STATE OF FLORDIA, INSURANCE DEPARTMENT; BRUCE W. FOUDREE, COMMISSONER OF INSURANCE, STATE OF IOWA; AND LAWRENCE H. THOMPSON, CHIEF ECONOMIST, GENERAL ACCOUNTING OFFICE, ACCOMPANIED BY MARK NADEL

Ms. DRISCOLL. Thank you, Mr. Chairman, members of the committee. For the record, I am Josephine M. Driscoll, president of the National Association of Insurance Commissioners [NAIC].

The NAIC is the Association of Chief Insurance Regulators of the States & Territories of the United States. I sincerely appreciate the opportunity of offering testimony before your committee on the very critical issues confronting the insurance industry and their impact on consumers, issues that are having a major effect on the manner in which insurance is currently regulated and which are forging the regulatory direction of the future.

The insurance industry is in the midst of the greatest period of change since the turn of the century. The current crisis has touched consumer in every State in the Union and has left virtually no line of commercial insurance unscathed. The crisis is twofold: A market crisis which relates to availability, and affordability, and a financial crisis regarding solvency. I will address solvency first.

I can tell you that insolvencies are not good for the employees of an insurer, the stockholders, the industry as a whole, nor the general funds of State governments which see a decline in revenue because of guaranty fund offsets.

Most importantly, insolvencies create tremendous problems for consumers. State regulators are endeavoring to find additional methods for earlier detection of company financial problems. The events of recent months enforce my belief that regulators have to move firmly and decisively to prevent further and more serious problems.

The activities of the National Association of Insurance Commissioners have become very significant. I am extremely pleased with the progress which has been made at the NAIC headquarters in Kansas City where the organization's data base has been enhanced to further develop the insurance regulatory information system, or known as IRIS.

IRIS's financial ratios are calculated annually for each company and the results measure solvency, liquidity, profitability, and other aspects of a company's operation. If the company's operations are not within acceptable parameters, it is identified for further regulatory attention. That attention comes from an NAIC examiner team, composed of experienced examiners from individual State insurance departments.

The 1984 industry results were dramatic. Data from over 5,200 companies were fed into the IRIS system. The examiner team reviewed in depth the data from 1,120 of those companies, and of that number 212 property casualty companies and 229 life companies were found to be in need of immediate regulatory attention, indicating that current operations threatened their short-term survival.

An additional 194 property casualty companies and 154 life companies were found to need targeted regulatory attention, indicating that current operations appeared to adversely affect their long-term financial condition.

Armed with that kind of empirical information, State regulators can move quickly and decisively to head off possible insolvency. Thus, IRIS is a very important tool that regulators can call upon to take a reading on solvency.

Even as we speak, work is in progress on the 1985 annual statements. Additionally, the States devote staff resources in excess of 6,000 personnel to the various regulatory functions. There are over 1,800 qualified and experienced financial and market conduct examiners, and the States contribute over $200 million each year toward the cost of regulation. States regulation is alive and well.

I could go on with the topic of solvency for the entire time allotted me today, but I do want to move on the second issue identified at the outset, that of the fate of the consumers in this present tight market.

The issue of consumer protection is linked with solvency, however, because it is a company's ability or inability to do business that creates the problems which we currently see in the marketplace. I am referring, of course, to the current market condition which finds insurers in the process of protecting surplus in capacity by taking a hard look at business which might have the potential to negatively affect profitability.

Those hard looks have created business practices such as midterm cancellations of entire books of business, midterm premium increases, questionable nonrenewal operations, and cancellations of agents who might specialize in certain types of business that the company has determined to reduce or eliminate.

In the midst of all this, the consumer, primarily of commercial insurance, who entered into a contract with a company for certain coverage for a certain period of time now finds the rules and the price being changed in the middle of the game.

We are confronted daily by bewildered, frustrated, and downright angry consumers, along with desperate agents searching for markets, a premium within reach, and a contract with coverages at least somewhere near what was provided previously.

On the other hand, companies are contacting us and pleading loss of reinsurance contracts, escalating adverse loss experience, and court interpretations which are eroding traditional, historical understandings of insurance contracts.

When these issues began to surface late in 1984, regulators were caught in the crossfire. On the one hand, they realized that solvency must be maintained in order to protect persons already insured, while on the other hand they were faced with the reality that the key to solvency for some companies seemed to unlock the door to questionable trade practices in the name of getting well.

Positive steps have been taken in an effort to redress these problems. Solutions by insurance regulators include:

Prohibiting insurers by law, order, or regulation from canceling policies midterm except for stated reasons, including nonpayment of premium, fraud, misrepresentation, illegal acts, or material increase, or change in the risk;

Requirement, either by statute or by regulation, that proper notice of nonrenewal up to 60 days is given to allow insureds sufficient time to identify alternative markets;

Adoption in some jurisdictions of market assistance programs or MAP's to create markets where none presently exist in order to match the buyer and seller of insurance;

Initiation by State insurance commissioners of market conduct examinations of insurers where market practices and activities have been questioned;

Formation of special task forces, either through the Governor's office, such as in my State, or insurance division, or the State legislature to review a State's particular problems and suggest legislative remedies.

The CHAIRMAN. Do you think you could summarize the rest of your statement?

Ms. DRISCOLL. All right. There are numerous proposals, as you have heard earlier, that there are particular pieces of legislation in all States, and I guess we can touch on those later.

The NAIC is continuing to exercise leadership in the area. We have created a national clearinghouse and advisory committee on availability to collect and disseminate information and we have also created a task force to study the impact of the legal system under Commissioner Fletcherbell of the State of Kansas.

The CHAIRMAN. Thank you very much.

Ms. DRISCOLL. There are a couple of other items on premium that I really would like to discuss a little further.

The CHAIRMAN. Could you do it in a minute?

Ms. DRISCOLL. I can try.

I will just say that there have been some examples of the great amount of premium increases we are hearing about. No one has testified to the fact that the last 4 or 5 years premiums have decreased considerably. In fact, some areas they are just now getting back to the levels of 1979. There was also a mention——

The CHAIRMAN. None of those people live in Missouri, though.

Ms. DRISCOLL. Apparently not, Senator.

There is also mention, for example, of the nurse midwives. At testimony that we heard in our State the other day, it looks like an immense problem, and it is for those midwives, but there are only 2,000 certified midwives nationwide; 70 of those are in Oregon.

Indeed, their premiums were only $38 a year and were increased to $1,000, but I think that we have to look at in the proper perspective of what some of these so-called incredible increases have been.

There are a number of rating practices. Some States have file and use, some approval of rates, and so on.

I do want to comment that I do feel that the present crisis is not wholly an insurance problem. It has many facets: the state of the economy, inflation, and resultant fluctuations in investment income, evolution of the tort system, and social attitudes toward insurance.

I suppose, Senator, that in view of the fact that we are discussing the future of State government, that we would like to have had more time to discuss our point of view, but I will close for now and have my colleagues add their comments.

The CHAIRMAN. Thank you very much.

Mr. Gunter.

Mr. GUNTER. Mr. Chairman and members of the committee, thank you for this opportunity to address this body on matters of vital concern to consumers and business people, to municipalities and nonprofit agencies across this country.

Rising costs, and scarcity of commercial property, and liability insurance threatens the survival of industries and main street businesses throughout the United States. The causes of this crisis include recent natural disasters, increasing litigation, and higher jury awards.

But as industry officials and State insurance regulators have frankly stated, the insurance industry itself is, in large part, responsible for the current crisis. Some have expressed reservations over the ability of the States to deal with this crisis.

We in Florida are keenly aware of our responsibility to meet the challenge. I strongly feel it is in the public interest to regulate the business of insurance at the State level, and the Florida response to the issues at hand is clear evidence that the States can do that job effectively.

This affordability and availability insurance crisis is cyclical by nature, as has been stated by previous witnesses. It has occurred repeatedly, Mr. Chairman, in the past. In 1976, the year I was first elected insurance commissioner of Florida, insurance cost and availability was a serious national issue.

But I must say, past experiences did not prepare us for the scale of this most recent market swing. In order to understand the practical effects of this crisis and to get the perspective of commercial insurance policyholders, we held hearings across Florida and asked people to tell us of their experiences. We were impressed by three trends above all: the sheer size of premium increases; the frequency with which premiums were raised or policies canceled, virtually without notice; and the numbers of policyholders with few or no losses whose coverage was terminated or lowered, or who had to pay tremendous price increases.

We have long been aware of the irresponsible practice of cash-flow underwriting, but we now see even more harmful and irresponsible actions by the insurance industry to make up for past mistakes.

The problem is deeper than just industry losses. It is a problem of the insurance industry's lack of commitment, if you please, to fairness and consideration for its policyholders.

In drafting legislation to deal with this crisis in Florida, we used a number of different but complementary approaches. We took a strong regulatory approach in proposing departmental review of rates, along with a mechanism to refund overcharges and windfall profits to policyholders.

We have also sought 60-day notification to policyholders of any premium increases or withdrawal of coverage.

On the other hand, we took a deregulatory approach in proposing to expand the list of professional groups in Florida who are allowed to self-insure, repealing stautory language, forbidding group commercial insurance, and creating a new insurance option called the limited reciprocal for groups of businesses.

Our proposal attacks the loss problem by offering financial incentives for loss prevention and safety practices through a risk management compensation fund created by industry windfall profits.

Additionally, we are proposing a commercial liability and property joint underwriting pool as an insurer of last resort to meet the needs of businesses and professions which cannot find coverage at any price in the standard market.

Finally, we are seeking to stimulate reinsurance capacity which is obviously now in short supply, by providing clear authorization for financial institutions to own or invest in reinsurance companies.

While I believe we in the States can do much to stimulate capital flow to this area, there is an important role the Federal Government, Mr. Chairman, can play here. Though it is contrary to current tax reform trends, I strongly recommend that investment tax incentives as still exist be retained, and that those which have been discontinued be reinstated to encourage additional capitalization of insurance companies in the United States.

There is also a need for Congress to explore ways to remove restrictions that prevent federally regulated financial institutions from investing in reinsurance facilities. And frankly, Mr. Chairman, I am hopeful that the appropriate committees in the Congress will look at the issue of the impending termination of the Federal Crime Insurance Program which, I believe, is due to end on March 16.

In my judgment, this is not good timing for that program to end. What we will find is that those inner core city businesses are going to have great difficulty in the current market in finding coverage.

As I have indicated earlier, I oppose repeal or modification of the McCarren-Ferguson Act. In my view, States should regulate the insurance industry. However, I believe it is abundantly clear that the

Federal Government retains the power to subject insurance companies to Federal antitrust laws if they have engaged in conspiracy, boycott, coercion, or intimidation.

Obviously, Senator Sasser agrees with that viewpoint.

As a Florida legislator and a U.S. Congressman, as well as an insurance commissioner and a former president of the NAIC, I have had many opportunities to deal with insurance issues from both a Federal and State perspective. My experience leads me to strongly urge that Congress continue to respect the traditional role of States in the regulation of the business of insurance.

Thank you, Mr. Chairman.

Senator DANFORTH. Thank you.

Mr. Foudree.

Mr. FOUDREE. Thank you, Mr. Chairman, members of the committee.

The CHAIRMAN. I am sorry, I mispronounced your name.

Mr. FOUDREE. It is Foudree.

I think the key to understanding the current problems of price and availability in today's insurance marketplace can be summed up in two words: "reserves" and "underwriting."

Today, insurance company reserves appear generally inadequate in liability insurance lines. The Insurance Services Office has estimated, for example, that there is an overall inadequacy of 40 percent for commercial liability coverages. Why?

Insufficient loss reserves can be traced to a number of factors including, No. 1, unprecedented, high liability losses of 1983 and 1984 which drained surplus or equity funds. Higher than expected losses meant too little reserves to pay claims over claims periods.

No. 2, a shifting legal environment.

No. 3, the current economy. There was a large drop in interest rates which resulted in a declining investment income for insurers.

No. 4, competition and cash-flow underwriting.

Let us consider the heavy losses first. To begin with, let me say that on several occasions, a gentleman by the name of Mr. Robert Hunter with the National Insurance Consumers Organization has quoted me, and unfortunately quoted me out of context.

I have said that in too many cases, insurers are not reporting numbers accurately. Mr. Hunter has used this to imply that insurers are overcharging and are hiding profits and surplus. This is absolutely not the case.

What I said, and what I say now, is that many times companies' loss reserve numbers are stated too low and surplus stated too high on financial reports. The fact is, underwriters have misjudged how large the losses are turning out to be. The losses are real, widespread, and very serious in liability insurance lines.

They have left many companies badly under reserved. Today, insurance examiners and management are frequently requiring that reserves be increased substantially. I can give you specific examples.In my judgment the trend toward steadily increasing losses and lost costs has not abated.

The second factor is the legal environment. Underreserving has been affected by and has been a product of the current unpredictability in the legal liability environment. Why should insurance regulators be concerned about this subject? Because the cause and effect relationship between these two major systems in our society is becoming increasingly evident. The deformities of the legal system are producing corresponding distortions in the ability of the insurance system to function today. The underwriting process is being severely tested by the judicial system. The increasing unpredictability of the civil legal system has made insurance underwriting virtually impossible in some lines today, so we ask the question, "Is the legal system, ipso facto, making insurers underreserved?" How can insurance examiners judge insurance adequacy in the current environment? Rising legal defense costs now appear to be running something like 25 percent of claims payouts. This is a factor in underreserving. Increased exposure of insurers to unforeseen risks has produced underreserving also.

I mentioned the economy and the problems with declining interest rates. I do believe that we are in a period of transition and adjustment; that the industry is now going through such a period; and that it will take time for insurers to adjust to the economy, just as other businesses and financial institutions are trying to do so today, including banks and savings and loans.

There is no question, however, that consumers have received a significant break over the past 5 years in the price of insurance products because of intense competition. I think competition has, in fact, resulted in underpricing. Price in many cases was established not on the basis of actuarial dictates but more on the basis of competition.

Let me summarize by saying that I believe a number of factors have been at the heart of the current availability problems. Unprecedented losses of 1983 and 1984, a shifting legal environment, a drop in investment income, cash-flow underwriting, and competition which has been, in some cases, cruelly intense.

These have produced underwriting which has been off target. Because that underwriting has been off target, the result has been underreserving or, if you will, inadequate reserves or reserves that have themselves been off target. This in turn has produced less capacity by insurers to handle more risks. In simple terminology, Mr. Chairman, what we have is demand exceeding supply. This very fact, I think, is at the root of why the prices are now increasing and why we are having availability problems or severe limitations in coverage.

In conclusion, I believe the States, as you have heard earlier, are responding and beginning to respond quickly in a number of areas to these problems. I believe that they should be given an opportunity to carry out the various legislative measures which are being passed in the States and the regulations and rules which are also being promulgated by the insurance regulators. These actions should be given an opportunity to work in accordance with the sound policy as outlined and contained in the McCarren-Ferguson Act. I would be glad to answer any questions that you might have and specifically to give you examples of where our insurance examiners have found serious cases of underreserving for various reasons.

Thank you.

The **Chairman**. Thank you, sir. I would like those examples for the record. If nobody asks for them and you have examples, I would certainly like to get them for the record.

Mr. Thompson.

Mr. **Thompson**. I will summarize my prepared statement.

Mr. Chairman and members of the committee, in 1979 GAO reviewed various aspects of the State regulation of insurance. Accompanying me today is Mr. Mark Nadel, the principal author of our report.

Although our focus was on automobile insurance, our review touched on several other aspects of State regulation. I understand the committee believes that the information we developed at that time, although dated, may nonetheless provide you useful background as you consider the problems of commercial liability insurance availability.

Our 1979 study reviewed the background, purposes, and need for insurance regulation; the resources and workloads of State insurance department; and insurance department surveillance of the financial condition, and trade practices of insurance companies.

We found thatonly a minority of the departments undertook systematic reviews of geographic availability issues—the so-called redlining issue—or of automobile risk classification systems.

We found only limited review of insurance underwriting standards; that only about a quarter of the departments had the authority to forbid the use of particular underwriting guidelines; and that most States had only limited ability to protect consumers against adverse underwriting decisions.

We found that while most departments did follow up on consumer complaints, many had only limited authority to resolve these complaints. Moreover, most departments did not systematically analyze complaint patterns to aid them in their general review and examination of insurance company practices.

We found that most departments did undertake periodic reviews of the market conduct of insurance companies, but we also found numerous shortcomings in the market conduct studies that they performed.

In short, we found in 1979 that in order to assure that insurance consumers in their State received adequate protection insurance departments needed more and better information about the insurance markets in their States and more systematic procedures for assembling and utilizing that information.

The General Accounting Office has several studies now underway which may be of interest to the committee. They are listed in the attachment to my prepared statement and include: An examination of the resources currently available to the State insurance departments of three States; a study of problems in the availability of environmental restoration insurance for motor carriers; a series of studies of problems in medical malpractice insurance,and potential approaches to solving them; a review of the effects of regulation on the cost and availability of automobile insurance, and a review of the effect of competitive rate making for workers' compensation insurance;

Each of these studies is in response to a congressional request and they are being executed in different parts of GAO. If the committee is interested in learning more about any one of them, I would be happy to work with the committee staff to arrange a meeting with the people knowledgeable about that particular job.

That concludes my statement.

[The statement follows:]

STATEMENT OF LAWRENCE H. THOMPSON, CHIEF ECONOMIST, U.S. GENERAL ACCOUNTING OFFICE

Mr. Chairman and Members of the Committee: I am pleased to appear here today to assist you in your consideration of current problems in the availability of insurance. I understand that the Committee believes GAO can supply some useful background information for your current deliberations by describing briefly our 1979 report entitled "Issues and Needed Improvements in State Regulation of the Insurance Business (PAD-79-72)." I am accompanied by Mr. Mark Nadel, the principal author of that study.

In our 1979 study we reviewed the background, purposes, and need for insurance regulation; the resources and workloads of state insurance departments; and the state insurance department surveillance of the financial condition and trade practices of insurance companies. We also conducted a more detailed analysis of the regulatory issues surrounding automobile insurance, such as risk classification, unfair discrimination, price regulation, and insurance availability.

Our study was based on three kinds of data. We sent a questionnaire to all state insurance departments of which 45 replied. We performed detailed fieldwork in the insurance departments of 17 states. And, we analyzed data from insurance industry sources.

While much of our report focused on personal automobile insurance, this morning I would like to summarize our findings in two, more generic areas: insurance availability, and trade practice regulation.

One of the issues of insurance availability that was of particular concern when we did our report was redlining—the arbitrary denial of insurance to everyone living in a particular neighborhood. We found that most states did not either systematically collect data or conduct special studies to determine if redlining exists.

Underwriting practices also affect insurance availability. While classification categories, such as territorial ratings, are based on explicit and objective categories, underwriting tends to be more subjective, and may lead to consumers' being denied essential insurance because of unsubstantiated judgments. At the time we did our study, questions had been raised about the propriety of certain underwriting guidelines. For example, at that time some underwriting manuals listed as "objectionable" such occupations as painter, automobile dealer, and waiter.

Only 26 percent of state insurance departments responding to our questionnaire reported that they had the authority to forbid the use of particular guidelines. Few state departments even reviewed or collected underwriting guidelines used by insurance companies at that time. Generally, departments collected only some manuals or portions of manuals.

Furthermore, we found that most states provided only limited protection to consumers who had adverse underwriting decisions. Individuals who are rejected for standard automobile insurance can usually obtain insurance through assigned risk plans, but may find that the coverage available there is severely limited.

With regard to consumer protection generally, we found that insurance departments lacked sufficient information to regulate effectively. While we did not examine all the data collection and analysis activities of state insurance departments, we found deficiencies in every one that we did review.

We examined in particular whether insurance departments were responsive to consumer complaints, and whether departments were able to find out whether particular companies or trade practices were creating problems for consumers.

Most of the departments we visited followed up on consumer complaints, but had only limited authority to do anything about them. Most state insurance departments did not have systematic complaint handling procedures whereby complaints were coded, analyzed, and used in the examination and regulation of insurance companies. Complaints could reveal a pattern of abuses by insurers or agents, but such information was generally not developed.

While most insurance departments undertook market conduct examinations which review trade practices, based on the examination reports that we reviewed, the market conduct examination process needed considerable improvements.

In short, we found in 1979 that the insurance regulatory process needed more and better information, and more systematic procedures, to assure that consumers received adequate protection.

In our review of automobile insurance regulation, we focused on two closely related issues: risk classification and price regulation. Risk classification is the division of risks by territories, and the use of age, sex, and marital status as indicators of risk. The structure of risk classification systems was at the time—and continues to be—a major issue in automobile insurance regulation. We assessed the extent to which the states have evaluated whether these plans constitute unfair discrimination, and found, in general that the states were not conducting adequate analyses to make that determination. With regard to price regulation, we found that there was almost no difference, on the average, in automobile insurance cost between states that require prior approval of insurance rates and those that do not. In the area of insurance prices, we concluded that less regulation was warranted.

The General Accounting Office has several studies now underway which may be of interest to this committee. They are listed in the attachment to my statement and include:

An examination of the resources currently available to the state insurance departments of three states;

A study of problems in the availability of environmental restoration insurance for motor carriers;

A series of studies of problems in medical malpractice insurance and potential approaches to solving them;

A review of the effects of regulation on the cost and availability of automobile insurance; and

A review of the effect of competitive rate making for workers' compensation insurance.

Each of these studies is in response to a Congressional request and they are being executed in different parts of GAO. If the committee is interested in learning more about any one of them, I would be happy to work with the committee staff to arrange a meeting with the people knowledgeable about that particular job.

This concludes my prepared statement. Mr. Nadel and I would be happy to answer any questions you may have.

CURRENT INSURANCE RELATED STUDIES AT THE GENERAL ACCOUNTING OFFICE

Insurance department resources

The Chairman of the Subcommittee on Commerce, Transportation, and Tourism of the House Energy and Commerce Committee asked us to review the resources available in the insurance departments of Ohio, Delaware, and North Carolina. We intend to compare what we find in 1986 to what we found in our 1979 study. This study is just starting; we expect to report our findings in late summer.

Environmental insurance for motor carriers

The Chairman of the Subcommittee on Surface Transportation of the House Committee on Public Works and Transportation asked us to look into the availability of environmental restoration insurance for motor carriers. As part of the this study, we are surveying insurance companies that write environmental restoration insurance and examining the practices of state assigned risk plans with respect to this form of insurance. We anticipate having a briefing report on this work in May.

Medical malpractice

The Chairman of the Senate Special Committee on Aging and Congressman John Porter requested a series of studies on medical malpractice issues. The first of the studies was released yesterday. It summarizes the perceptions of national organizations about current problems, proposed solutions, and the role of the federal government in dealing with malpractice problems. It also describes some of the alternatives to the tort liability system that have been proposed as ways of dealing with medical malpractice.

The second study, which we expect to complete in July, will focus on the costs of medical malpractice insurance to hospitals and doctors. The third study, which is scheduled for completion in Octobers, will examine the current malpractice situation in six states regarding the frequency and severity of malpractice claims and their impact on the cost and availability of insurance. The fourth study will look at characteristics of malpractice claims closed in 1984, including the size of the loss sustained, the size of the insurance settlement, and the time required to settle the claim. Current plans are to complete this study in November. Finally, we plan to issue a "capping report" in March of 1987 pulling together the information contained in each of the first four studies and will include matters for consideration by the Congress, as appropriate.

Automobile insurance

At the request of the Chairman of the Subcommittee on Commerce, Transportation and Tourism of the House Energy and Commerce Committee (subsequently joined by the Chairman of the House Committee on the Judiciary), we are reviewing the effect that competitive rate making has had on the availability and affordability of automobile insurance. We are also examining the compatibility between competition and nondiscrimination in automobile insurance rating plans. This report should be released in May.

Workers' compensation

At the request of the Chairman of the Subcommittee on Entrepreneurship and Special Problems Facing Small Business of the Senate Committee on Small Business, we are examining the experiences of states that have recently instituted competitive rate making for workers' compensation insurance. One of the concerns we are looking into is the effect of the change on small business. We expect to report on this work in the middle of the summer.

The CHAIRMAN. Mr. Thompson, do you believe that the 1979 study is still valid today?

Mr. THOMPSON. I really cannot answer that. We are now looking at three States to see to what extent some of the findings in the 1979 study are still valid. But we have not been monitoring developments in State insurance departments regularly over the last 7 years.

The CHAIRMAN. Let me ask the State commissioners:

Mr. Foudree said that competition in the insurance industry has been—I think his words were "cruelly intense."

Is it the view of all of you that the insurance industry is highly competitive or do you think that it is basically noncompetitive?

Mr. FOUDREE. Speaking from my experience in my own State and what I have seen throughout the country during the presidency of the NAIC, I would say it is very competitive.

The CHAIRMAN. Do you agree with that, Mr. Gunter?

Mr. GUNTER. Mr. Chairman, sometimes competitive, to its own detriment, for example, in the instance cited where cash-flow underwriting seemed to preempt all other considerations in recent years, we saw the industry engaged in cutthroat pricing and they cut their own throats.

The CHAIRMAN. Do you think that it is competitive?

Mr. GUNTER. Yes.

The CHAIRMAN. Ms. Driscoll, how about you?

Ms. DRISCOLL. The State of Oregon was the first State, Mr. Chairman, to implement competitive rating in workers 'compensation. We saw dramatic drops in rates and a lot of competition. Those rates are coming back up now because, as we indicated earlier, the rates were too low in the past 4 or 5 years.

The CHAIRMAN. So you think that it is basically a competitive industry?

Ms. DRISCOLL. Absolutely.

The CHAIRMAN. Is reinsurance a competitive industry?

Mr. GUNTER. Mr. Chairman, it is competitive to the extent that it obviously is a major piece with respect to the standard sale of insurance in the marketplace.

The **Chairman**. But what I am saying is is there competition in reinsurance?

Mr. **Gunter**. There is less competition today because of capacity problems among reinsurers themselves. Let me point out that——

The **Chairman**. Let me get to the heart of the question.

The comment has been made by Ralph Nader and by other witnesses a few days ago and then it was—at least the possibility was raised by Senator Sasser today that there are boycotts in the insurance industry and that that is part of the problem.

Do you—do any of you have any evidence that there is some sort of combination in restraint of trade or anticompetitive boycott that is going on in the insurance industry?

Ms. **Driscoll**. Mr. Chairman, I do not believe that there is a competitive boycott. I do know that insurers in my State, for example, have had difficulty getting reinsurance on some lines of insurance. So unless you have a lot of people willing to write a product, it is not as competitive as it might be. But it is noncompetitive for valid reasons.

The **Chairman**. Right. But do you have any evidence at all of any boycott or any combination or conspiracy?

Ms. **Driscoll**. No, sir.

The **Chairman**. Do you all agree?

Mr. **Foudree**. No.

The **Chairman**. Mr. Gunter.

Mr. **Gunter**. I would be in a better position to answer that now that we have implemented a change in the law in Florida, which allows us the opportunity to review reinsurance treaties, which are between the reinsurer and the primary insurer. But I certainly have no evidence at the present time of any such boycotting.

The **Chairman**. Either in the insurance or the reinsurance industry?

Mr. **Gunter**. That is correct.

The **Chairman**. OK.

Do you, as Senator Dole would say, does the Kasten bill, relating to expanding the Risk Retention Act give you heartburn?

Mr. **Foudree**. Well, I am very concerned about it. I think based upon past experience—you are speaking to the Risk Retention Act, is that correct?

The **Chairman**. Yes. And the expansion of it.

Mr. **Foudree**. Yes. I think that other regulators are concerned about it, too. I cannot speak for all of them, but I will say that the primary concern here is if we do this, how will it be regulated? How are you going to monitor the adequacy reserves in those situations?

I think it is probably a short-term solution that will not solve the problems in the long run.

Ms. **Driscoll**. Mr. Senator, I do want to add to that that in addition to trying to find markets for people to buy insurance, you have to look a little further and look at people who may have claims against those individuals who are self-insuring. And you must have some assurances that there is going to be money there to pay for those claims.

The municipality situation that was mentioned earlier—there is relief now in the States for those. In our State, for example, municipalities have asked for legislative relief and are allowed to self-insure a portion of their loss and also to group together.

So there is relief on a State basis. If a municipality were unable——

The Chairman. It does not help much, though, for companies that are doing business in all kinds of States, does it?

Ms. Driscoll. Well, I think what we are forgetting in some instances the reason is some of the companies that are unable to get insurance is because they have very bad loss ratios and they ought to look to that and try to correct those in addition.

But you do need the safeguards to protect the people who have claims against those companies.

The Chairman. Senator Rockefeller.

Senator Rockefeller. Just a quickie.

You indicated in your response to the chairman that, within the Risk Retention Act, and the amendments to it, there could be a short-term solution to the insurance problem. But then your basic response was yes, it does give us problems.

Now supposing it only gives you problems if it is a long-term solution. We have a lot of communities which are now all of a sudden, in desperate straits—one of which will testify later on from my State. These commmunities are not able to get any insurance at any price from anybody except, a Turkish firm. Why would you be against something which you indicate might be a short-term solution? In other words, if it troubles you, does it trouble you enough that you are against it or are you only against it if it is the long-term solutions?

Ms. Driscoll. Well, I believe that all self-insurance?– there is no regulation whatsoever on self-insurance programs. And so somewhere along the time, I think there should be some safeguards built into such a program to protect the people who may have claims against those municipalities.

And the reason that I suggested in a municipality situation, going to the State because municipality self-insurers cannot pay their claims, where does the money come from to pay those claims? You have to go back to the taxpayers of that community. I think they should be ones making the decisions whether and the legislators of that particular State—whether or not they want to assume that obligation.

The Chairman. If I can maybe give you one Tums for the heartburn here. Just reading from a description of the risk retention bill to ensure the solvency of such groups, the act authorizes the State insurance commissioner in any State, which a risk retention group is doing business to examine the group's financial condition, if the commission has reason to believe that the group is financially impaired and the chartering State has not begun or has refused to initiate an investigation.

Ms. Driscoll. Senator Danforth, what standards do we base that on? Are you going to give us the authority to base those standards on the same standards we would apply to an insurance company authorized to do business, the same capital and surplus requirements?

You have to some standards for us to be able to——

Mr. Gunter. The problem is when you state the commission has reason to believe that the entity is financially impaired, that is a rather serious charge. And I would hope, if you go forward with this legislation, you would set, as Commissioner Driscoll has indicated, more specific standards for the State commissioners to act.

Otherwise, it makes it very difficult under due process for us to move in, as you can well understand, Senator.

I might also respond, if I could, to Senator Rockefeller's query. Florida has had very good experience, Senator, with respect to local government insurance pools for both cities, as Commissioner Driscoll alluded to, as well as school boards and the like. And I would hope that in West Virginia perhaps you all might look at that program at the State level because, as has been pointed out, it has enjoyed significant success.

For example, in our State, for a number of years we never had an assessment under the State self-insurance pool from municipalities. It has worked well there and perhaps might work well in West Virginia.

The Chairman. Senator Gore.

Senator Gore. I will be brief, Mr. Chairman.

Mr. Gunter, you mentioned that some policyholders with few or no losses at all have either lost coverage or had these enormous increases. Why is that, in your view? Is it just a measure of the way risk pools are defined?

Mr. Gunter. Senator Gore, I wish I were in a better position to respond to that question. We have asked for legislation in Florida which ~~will~~ give the insurance department the ability to review the rate filings and the underwriting standards in the area of commercial liability and property insurance, wherein we can make judgments in that regard.

But I am quite concerned when I see classes of business such as day care centers, as one example, where there have been some notable national examples of problem cases, perhaps involving child molestation and the like. And yet when you review the class of business across the board in Florida, there have been very, very few losses to insurance companies.

But it is that class of business that has experienced rate increases of 300, 500 or more percent. And I have little comfort in not being able, at the present time, as head of the insurance department, to look at the statistics upon which those increases are based, or to review the surcharges that have been alluded to in prior testimony.

We do have the rates filed with the Department of Insurance, but current Florida law doesn't require surcharges or premium credits or the like to be reposed in the insurance department. And many insurance companies, in fact, do not give us that data or information.

So the bottom-line premium charges are not in some cases being filed with the insurance department. We requested the additional rate review authority back in 1982 when we saw some of these storm clouds forming, but at that point, we had high interest rates, we had stability in the pricing of commercial liability and property insurance and so we had few allies in the legislative process and we did not succeed in getting that authority.

I think we are going to succeed this year. We have got a lot more friends.

Senator GORE. Well, it leaves the impression that a few people in the reinsurance market operate on anecdotal evidence about particular lines of business.It appears that, in dealing with a very large risk pool, like the United States of America, they become nervous about lines of business generally. In discussing these lines a reinsurer might say, for example, "Gee, I saw this newspaper article about these lawsuits involving a day care center out in California. Did you read this?"

And the first thing you know, the reinsurers have said, "We better get out of that line of business altogether."

I mean that is just the impression that I am left with.

Mr. GUNTER. Senator, I have similar concerns to those you express. And it is for that very reason that in Florida we are requesting the rate review ability, not power approval of these rates, but the ability to look at them after the industry has filed them and to apply standard actuarial procedures to be sure that there is not an overcharge involved.

Senator GORE. Do you recommend any protections at the Federal level?

Mr. GUNTER. I do not.

Senator GORE. Do any of the other panel members wish to comment on this exchange?

Ms. DRISCOLL. I find that in our State we have the same problem with the day care center situation that you mentioned, Senator. And in looking into it, we found that the loss experience was very good in our State. In talking to a great many of the day care center people, however, I found that a day care center, for example, that have 30 children, their charges in the past had only been $108 a year. That was totally inadequate because one skinned knee, and you have got that much. The rates did go up to $1,200.

But even the people who were involved in the day care center felt that even though that was a tremendous percentagewise increase, they felt it was acceptable.

And no, we do not feel there that we need any Federal laws.

Thank you.

Mr. GUNTER. You were out of the room, I believe, when I made the one comment relative to reinsurers, which I would like to restate. And that is I do think it would be well at the Federal level for the Federal Congress and/or regulatory agencies to look at the issue of allowing freedom on the part of financial institutions, regulated at the Federal level, to invest in reinsurers.

There is certainly a problem of lack of capital, lack of capacity, with respect to reinsurers and we in Florida are trying to remove any legal impediments whatsoever for State chartered financial institutions to so invest. We would hope that you all would look at the issue at the Federal level. We think that would be helpful in the face of what we have heard from the Lloyd's representative that obviously offshore reinsurers are pulling back.

We have a little Lloyd's of London in Florida. We have our own insurance exchange of the Americas. And we would encourage banks, S&L's and other financial institutions to participate in those syndicates to help to supply reinsurance needs. They need the capital that these financial institutions can offer.

Senator GORE. Thank you, Mr. Chairman.

Senator ROCKEFELLER. Mr. Chairman, I hate to do this, but I want to get one thing on the record, if I could, to Mr. Thompson.

You indicated earlier in your response to the chairman that in 1979 you looked at a variety of deficiencies. The world has changed in this whole situation between 1979 and now. You indicated that you are looking at several studies, some of which include several States, perhaps, and then several factors.

I think it is very important to get an update on the 1979 study to look at how the States' insurance departments are managing their regulatory practices.

Mr. Gunter has suggested that West Virginia could do what Florida is doing. Indeed, our legislature is working on it right now. But we may very well be, and probably are, too small to handle this problem all by ourselves. We may have to get into a pool with other States—neighboring States, perhaps.

I was Governor of West Virginia for 8 years; our insurance department was and still is extremely small. It could be that back in 1977, when I became Governor, that that was suffiecient, but now, in the light of crisis, more people are needed.

I would like to ask to update that 1979 study.

Mr. THOMPSON. We are undertaking a portion of that. That is the first item on my list. We have a request from the House Energy and Commerce Committee to look at State personnel—how many they have got, what they are doing, and what their training is. We are not redoing the whole 1979 study.

Of course, as I said, much of the 1979 study looked at automobile insurance, which doesn't seem to be that much of a problem today.

Senator ROCKEFELLER. Would it be limited to these four items here in your statement?

Mr. THOMPSON. No. I described [it] the study later on in a paragraph. We were asked to look at Ohio, Delaware and North Carolina, and to look at the professional resources available—what the people are doing, what the budget looks like.

The CHAIRMAN. Thank you very much for your testimony.

The next panel is Mr. Michael Mullen, Crowell and Moring; Ms. Karen Ehrnman, American College of Nurse-Midwives; Jack Floyd, Tennessee Municipal League, Risk Management Pool; Bruce Parker, National Solid Wastes Management Association; Ronald Stasch, Risk and Insurance Management Society; and Allen Sigoloff, representing the American Camping Association.

Mr. Mullen.

STATEMENTS OF MICHAEL J. MULLEN, OF COUNSEL, CROWELL & MORING; KAREN EHRNMAN, RN, MPH, GOVERNMENT RELATIONS COORDINATOR, AMERICAN COLLEGE OF NURSE-MIDWIVES; JACK FLOYD, EXECUTIVE VICE PRESIDENT, TENNESSEE MUNICIPAL LEAGUE, RISK MANAGEMENT POOL; BRUCE J. PARKER, GENERAL COUNSEL, NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION; RONALD STASCH, RISK & INSURANCE MANAGEMENT SOCIETY, INC.; AND ALLEN SIGOLOFF, REPRESENTING THE AMERICAN CAMPING ASSOCIATION

Mr. MULLEN. Good morning, Mr. Chairman, members of the committee, my name is Michael Mullen. I am of counsel to the Washington, DC law firm of Crowell & Moring.

In the course of my legal practice I have provided counsel to organizations which have established risk retention and purchasing groups under the Product Liability Risk Retention Act. In addition, our firm has provided counsel to various trade associations, nonprofit institutions, and companies regarding alternative methods of insuring or protecting against liability for damages arising out of operations, product and services.

The committee has asked me to testify about the liability insurance crisis, and tell you if any action by Congress can assist in solving it. My answer to this question is very simple, and I can give it to you in one sentence: Congress should broaden the Risk Retention Act to permit self-insurance and the group purchase of liability insurance for all forms of general liability risks faced by businesses, trade associations, nonprofit organizations, and municipal governments.

This action appears to me to be the simplest, least-risky way in which to help firms and organizations unable to obtain liability insurance to protect themselves against the risk of lawsuits and potential financial ruin.

Before I explain to you why I say that, I want to make clear that the Risk Retention Act is not a panacea. It will not solve all the problems which have created this liability insurance crisis. In particular, it does not address the underlying problems of tort law which require the attention of both Congress and State legislatures. And the Risk Retention Act will not necessarily solve the liability insurance problems of every particular group, or every risk. But to say that it does not cure every problem, does not discredit the meaningful benefits that it will provide.

Let me say that I believe there is a serious tort liability crisis, and a serious crisis regarding liability insurance coverage. I think this is generated not only because of cash flow underwriting, but also because of the fact there is a serious problem with increased claims.

There were 1,500 product liability cases filed in the Federal courts in 1974. That number exceeded 10,000 in 1984. The rate of medical malpractice claims against physicians was 2.5 per 100 in 1976, but it reached 16 per hundred in 1984. Lederle Laboratories now faces claims for damages of more than $3 billion involving vaccines that they have produced.

I think these facts demonstrate clearly that there is a liability insurance crisis which justifies price increases by commercial insurance companies, and which makes the action taken to restrict coverage in certain very high risks a prudent business decision. That is the reason why I think it is essential for Congress to take action to assist those persons and organizations and companies that cannot obtain insurance to set up self-insurance plans.

I think I can best explain why it makes sense to consider broadening the Risk Retention Act by relating conversations and meetings that I have had with persons who wanted to explore what they could do about their liability insurance problems.

In one case a few months ago I met with an organization of hazardous waste treatment companies who were experiencing difficulty in obtaining pollution liability insurance. They explored the question of whether they could form a Risk Retention Act. I said that that was not permissible because what they wanted to cover was not product liability insurance.

Subsequently I had discussions with persons involved in the restaurant business who had trouble getting liquor liability coverage, and meetings with other persons who needed other kinds of liability insurance coverage. All of these groups were interested in obtaining coverage for something other than product liability insurance, and therefore it was not permissible for them to form a Risk Retention Act.

They all asked me, well, what can we do? I explained that insurance is regulated by the states. If you wanted to set up an insurance program, you would be required to be admitted to each State that you wanted to operate in. If you wanted to operate in all states and the District of Columbia, you would have to be approved in 51 states.

It can be a very burdensome and time-consuming project to establish a nationwide insurance company, and you might run into problems in obtaining approval of your policy forms. State insurance regulations provide that you have to get your policy forms approved. That makes sense in terms of the ordinary homeowners coverage and automobile liability coverage. The insurance regulators protect the ordinary citizen to make sure that those policy forms provide real coverage.

Also, if you set up a regular insurance company you are required to have your rates and your rating plan approved in each state. Well, what happens when companies try to set up special insurance programs? The State regulators in each particular state may say, well, why do you have this exclusion? Why do you have this coverage?

Mr. Parker is going to testify about a pollution liability group insurance program that his organization has established. When a group of firms have their own legal experts that look at these programs and they decide what coverage they want, it seems to me that it is not necessary to have 51 state regulators approve this same policy which all the members of the group have decided is the kind of coverage that they want, and it contains the kind of exclusions that they want.

That is really the heart of the reason why I think the Risk Retention Act is needed. It is too difficult today to establish a nationwide self-insurance program. What the Risk Retention Act does is simplify regulation. It provides that a group will be regulated by the insurance department of the State in which they are organized. I think that provides sufficient protection of the policyholders and consumers, because the alternative is that these groups cannot get any insurance at all. And the public is certainly not protected in that case, and the institutions are certainly not protected if they have no insurance.

The other alternative is that they are forced to go offshore and carefully structure an insurance company in Bermuda or elsewhere which is not regulated at all by State insurance departments. So that is the reason why I think broadening the Risk Retention Act is the least risky and perhaps the most helpful step the Congress can take to deal with the immediate unavailability crisis. Thank you.

The CHAIRMAN. Thank you, sir.

[The statement follows:]

STATEMENT OF MICHAEL J. MULLEN

Before I explain to you why I say that, I should make clear that broadening the Risk Retention Act is not a panacea. It will not solve all of the problems which have created the liability insurance crisis. And, it does not address the underlying problems of the tort law system which require the attention of both Congress and state legislatures.

Broadening the Risk Retention Act will not necessarily solve the liability insurance problems of every group or every risk, but it will provide an additional method for establishing group self-insurance and group insurance programs. I hope that my explanation of the benefits of this action will not be misused by possible opponents to it. To say it does not cure every problem, does not discredit its meaningful benefits.

THERE IS A REAL TORT LAW AND LIABILITY INSURANCE CRISIS

There is a serious liability insurance crisis. Many firms and organizations cannot purchase liability insurance coverage, or are being quoted prices they cannot afford. This is not a phony crisis caused by some invisible conspiracy by insurance companies to force Congress or state legislatures to enact tort reform legislation. It is abundantly clear that there are more personal injury lawsuits against manufacturers, doctors, municipal governments, architects, and others resulting in larger judgments today than there were ten years ago. Product liability claims filed in the federal district courts have increased from 1500 cases in 1974 to more than 10,000 in 1984. Medical malpractice claims against doctors were filed at a rate of 2.5 per 100 in 1976, but reached a rate of 16 per 100 in 1984. I believe that the serious losses incurred in the property-casualty insurance industry in the last two years require and justify (with a few exceptions) substantial price increases and restriction of the market with respect to high risk businesses and institutions. It is because I think the insurance crisis is real, that I am led to recommend broadening the Risk Retention Act.

RESTRICTIONS IMPOSED BY EXISTING REGULATION

Maybe I can best explain why Congress should take action to facilitate group self-insurance by relating conversations and meetings I have had over the last several months with persons seeking advice on how to organize self-insurance programs. I won't identify any particular client or person with whom I've spoken, but what I say will reflect the substance of several conversations and meetings. In one case, I met with an organization of hazardous waste treatment companies who were experiencing difficulty in obtaining pollution liability insurance. We explored the question about whether they could create a risk retention group. I advised them that under existing law, it was probably not permissible. That let to a proposal, included in the current Superfund amendments, to broaden the Risk Retention Act to cover pollution liability risks.

Subsequently, I have had discussions with persons involved in the restaurant business (who had trouble getting liquor liability coverage), and persons seeking other coverages. Since all of these groups were interested in obtaining liability insurance coverage for risks other than product liability, I had to advise them that they could not establish a risk retention group.

In a number of cases, I explored with these organizations other insurance options that might be available. I explained that the business of insurance is regulated by state law and that if an organization established an insurance company to insure the liability risks of its members, it would be required to be admitted as an insurer in each state in which it sought to conduct business and would be required to obtain the approval of its policy forms and rates in each of those states. If it wanted to operate on a national basis, it would be required to obtain approval in 51 jurisdictions. I further explained that this could be a very time-consuming and lengthy administrative burden for any small insurance organization.

I told them that if a group developed a special insurance policy specifically tailored for its needs, it might run into some problems in obtaining approval of its policy form since examiners in various state insurance departments closely scrutinize any deviation from standard policy forms and might demand extensive justification for any such variations. I also said that state insurance agencies would have an organization over the barrel, to the extent that if they did not consent to modification of their policy form, it might not be approved. This, in turn, might prevent a group which wanted to have a uniform policy form, applicable to all members, from accomplishing that goal. This might happen even if all the members of a group agreed on a coverage or an exclusion, and believed it was essential to their program.

The same dilemma would be true with respect to rates and the rating plan for a new insurance organization. Even if the group consulted legal experts and engineering experts, and obtained the assistance of top consulting firms such as Tillinghast or Wyatt & Company, they would still have to run the gauntlet of 51 state regulatory agencies who would examine their rates. And, even if there were not enough losses projected in any particular state to establish credible rates for losses that might be expected to arise in that state, the organization could still be required to supply a considerable amount of data to each state insurance department to explain its rates and rating plan. As you can appreciate, this approval process can be a tedious, time-consuming, and expensive undertaking.

So the advice that a group seeking to establish a self-insurance program is left with is this: Under existing state insurance regulation, they must run the gauntlet of a very cumbersome, slow, and potentially expensive regulatory system in each of the 50 states and the District of Columbia, if they wish to establish a national insurance program.

There are only two other alternatives—one is going without insurance a risking shareholders equity in the case of corporations, or facing potential personal liability in the case of officers and directors of a non-profit organization. The other alternative is to use very careful legal planning and establish an offshore captive insurance company that conducts its business without using the services of any admitted insurance carrier or any licensed agent or broker, thereby avoiding state insurance regulation altogether.[1] That is, in fact, what many large corporations and some other groups do to avoid the red tape of state insurance regulation.

But, do you know what? Many of the firms and organizations that I have had discussions with are very patriotic. They don't want to have to go overseas to establish an insurance program. They do not understand why we cannot make the regulations here in the United States simple and appropriate for the kind of insurance programs they want to establish. And frankly, I don't understand why either.

So, what are we left with? Either these companies and other organizations go bare, or they go overseas.

The market assistance programs established by state insurance departments may be helpful for some relatively low-level risks, but no state market assistance programs can identify any significant markets for pollution liability insurance. And, to my knowledge no state market assistance program has identified an underwriter for nurse mid-wives. I don't object to these market assistance programs, but Congress should be realistic—do you really think these programs are going to find underwriters that will provide the level of directors and officers liability insurance coverage that is being sought by banks and savings and loan associations, and other special risks? I don't expect the market assistance programs to find to many insurance markets that haven't already been identified by leading agents and brokers.

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[1] Technically, there is another option available: marketing coverage underwritten by an offshore captive through an admitted insurance carrier which assumes a small part of the risk and "fronts" for the captive. Fronting company arrangements are not easy to obtain in this hard market.

EXPERIENCE UNDER THE EXISTING ACT

Only a small number of groups have been formed under the existing Risk Retention Act. The reason for this is very simple: cheap commercial insurance was available until 1985.

My advice to anyone considering the formation of a risk retention group has been consistent over the past three years—don't form a group if you can obtain adequate commercial insurance at reasonable rates. Since very cheap coverage has been available, there generally has been no need to establish risk retention groups. The one exception is homebuilders.

The Homeowners Warranty Corporation established HOW Insurance Company as a risk retention group in 1981 because the commercial insurance underwriters, who had provided this coverage, planned to withdraw from the market. The HOW risk retention group is now a large national program which insures homebuilders against liability for certain defects in new homes. HOW's assets are now more than $47 million.

The National Association of Wholesaler-Distributors has established a purchasing group program which provides a specially tailored general liability insurance policy to its members. As I understand it, this is a very successful program with several million dollars in premium volume.

The National Federation of State High School Associations has established a purchasing group to insure itself, state associations, and school districts against potential liability arising out of catastrophic athletic injuries occurring in the course of interscholastic sports competition. This program provides special liability coverage for approximately 75% of the high schools in the United States.

These organizations constitute the only significant national groups organized under the Act, although there may be other smaller local or regional programs which have been established.

Even though the number of organizations that have established risk retention groups or purchasing groups under the existing law is small, that does not mean that this is insignificant legislation. The Risk Retention Act functions as a safety vale. When businesses or other organizations are unable to obtain liability insurance coverage and want to form self-insurance programs, they will have available the streamlined regulatory system established by this Act. They will not longer be left without options if the commercial insurance companies are unwilling or unable to provide coverage.

If the insurance market remains tight and Congress chooses to broaden the authority of the Act, it is likely that more groups will be formed. I have received more calls about the Risk Retention Act since January 1 than I received in the last three years.

RECOMMENDED ACTION

The real question before Congress is whether they should throw up their hands and do nothing, or consider legislation that will allow those who cannot obtain liability insurance to establish self-insurance programs. The framework for such insurance mechanisms has been established by the Risk Retention Act of 1981. It should be broadened to cover all liability insurance risks, with the possible exception of workers compensation insurance.[2] This authority should not permit coverage of personal lines insurance, such as personal automobile liability insurance and homeowners insurance. Nor should it permit coverage of health and life insurance or other lines of insurance.

The goal of insurance regulation is to ensure the reliability of the insurance product and to encourage fairness, equity and reasonableness in the relationship between the insurer and the insured. If you have a situation in which businesses and other organizations are unable to obtain liability insurance coverage from commercial insurers, and they agree among themselves on the terms of their coverage and the rates, then there is no need for some paternalistic bureaucratic review of these freely made contractual arrangements. Only perverse logic places "preserving total regulation" over making coverage available to willing, knowledgeable buyers.

As far as assuring the reliability of insurance and the solvency of risk retention groups, I think the scheme set forth in the existing Act is adequate. It places responsibility squarely on the Commissioner of the State in which a Risk Retention Group is licensed. In contrast, the existing system of state regulation results in a dispersion of responsibility which has not and cannot prevent insolvencies, as we know from the notorious cases of Baldwin United, Mission, Eastern Indemnity, and many other companies who have become insolvent in the last two years.

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[2] There is no similar crisis in the availability of workers' compensation insurance.

It is my opinion that companies and other organizations which join a self-insurance program have a greater incentive to assure that their premiums, surplus, and reserves are sufficient to pay claims, than if they purchase insurance from a commercial company. That is so because each member company of a self-insurance group realizes that if its funds are insufficient to pay claims, the company and its shareholder equity will be at risk. Should a self-insurance plan fail, the company may be required to include that information in its quarterly SEC filings, and it may experience greater difficulty in obtaining bank loans and otherwise conducting its business.

I believe all of these factors, in addition to the regulation and supervision by the insurance department of the state in which a risk retention group is established, provide strong incentives to assure adequate funding of these groups. In addition, the Risk Retention Act provides authority for other state insurance departments to examine a risk retention group if they have "reason to believe" that a group is financially impaired.

PURCHASING GROUPS

Let me comment briefly on purchasing groups. A purchasing group is a group of persons which has as one of its purposes the purchase of liability insurance on a group basis. It is not a self-insurance entity, rather it is a method for reducing insurance costs and obtaining favorable coverage terms by means of mass purchasing. An individual firm or organization standing alone may not appear to be an attractive risk because its potential for loss, measured against the premium that would be charged, does not look favorable from the standpoint of an underwriter. On the other hand, a group of such firms or organizations which have established a loss prevention plan, and whose aggregate premium is substantial, will appear to an underwriter to be a more favorable risk. In addition, to the extent administrative expenses and commissions can be reduced through group purchasing, additional savings in premiums can be achieved.

The purchasing group authority is an essential complement to the risk retention authority created under the Act. In order to achieve the benefits of simplified regulation for purchasing groups, it is essential that these programs be exempt from rate regulation and the requirement that their policy forms be approved in each state. The reasons for such an exemption are the same as those I discussed with respect to risk retention groups. If a group of purchasers advised by their attorneys and risk managers agree to special coverage terms specifically tailored to their needs, there is no need for each state insurance department to review the terms of coverage; with respect to rates and the rating plan, a group program with voluntary participation cannot be established unless the premiums are set according to the same rating plan applicable to all members in all states.

Next let me explain why another proposal that has been suggested, will not solve the liability insurance crisis.

A FEDERAL REINSURANCE PROGRAM

It has been suggested that the federal government should establish a reinsurance program to assure that liability insurance is broadly available at reasonable rates to all persons seeking liability insurance coverage. As I understand it, commercial insurance companies would forward a portion of the premium they have collected to the federal government which would "reinsure" a portion of that insurer's coverage. For example, the program might specify that if the aggregate liability losses of that insurer exceeded a specified amount, the federal government would pay all of the losses (up to the limits of the policies) in excess of the specified amount.

Although I have a high regard for Robert Hunter and I think he has many interesting insights and observations regarding the business of insurance, I have grave reservations about this reinsurance proposal. I am concerned about its feasibility and its operation, and I am particularly concerned because it would appear to expose the federal government to millions and potentially billions of dollars in losses for risks that it reinsured. Let me explain why.

First, it should be noted that the federal government's riot insurance program covered property losses. The administrative costs of a property insurance program are far less than those of the liability insurance program. That's because it is first-party insurance. A loss is a loss. There is generally no issue regarding liability. Second, determining the value of a property loss—which is limited to economic damage—is far simpler than attempting to determine potential losses for damages for pain and suffering covered under a liability insurance policy. It is also far more difficult to project potential liability losses because of the uncertainty regarding future changes in tort law. For example, how would you determine the potential reinsurance premium for vaccine liability? Would a commercial insurance company charge a low premium, with the federal government picking up the liability if the courts should at some future time impose liability for all vaccine injuries?

I would like to note another fundamental problem with regard to any government reinsurance program. The Urban Property Protection and Reinsurance Act of 1968, the Riot Reinsurance Act, was intended to reinsure against "environmental hazards" which were defined in the Act as "any hazardous condition that might give rise to loss under an insurance contract, but which is beyond the control of the property owner." 12 U.S.C. § 1749bbb-2(a)(4). In other words, the Riot Reinsurance Act provided protection against losses which the individual policyholder was not capable of preventing.

In contrast, a government reinsurance program for liability risks generally would have the Federal Government assume responsibility for losses which are, to some extent at least, within the control of a policyholder, and can be reduced or limited by actions taken by the policyholder. I believe that the marketplace, not government a agency is the best means for determining the potential risk of loss caused by the operations or products of chemical companies and drug companies and by the operations of restaurants, amusements parks, swimming pools, athletic facilities and other activities that need liability insurance.

Mr. Hunter bases his reinsurance program on experience derived from automobile liability insurance and homeowners insurance where there are millions and millions of policyholders and thousands and thousands of claims which are largely homogenous although they vary slightly from territory to territory. I do not believe that these concepts can be realistically applied to the variety of businesses and other organizations seeking various forms of liability insurance with various limits of coverage. A company that makes plastic tubing used to mix coke syrup and carbonated water used in a soda fountain does not have the same risk of liability as a company that makes plastic tubing used in an artificial heart pump machine.

But even assuming you could establish credible loss data for all of the thousands of subsets of risks for various activities insured under general liability insurance policies—which I contend cannot be done—that would still not solve the overwhelming problem that would face any government reinsurance program. Examining all of the loss data in the world cannot tell an underwriter what amount of "safety loading" is needed to cover the potential losses resulting from major changes in tort law rules.

For all of these reasons, it appears to me that a federal reinsurance program for liability insurance is an impractical and dangerous solution to the liability insurance crisis. It is unworkable, unless the federal government is willing to assume the risk for all losses above some arbitrary amount that can be covered by arbitrarily established "reasonable" liability insurance premiums. It is difficult for me to conceive that a Congress seriously attempting to reduce the budget deficit could entertain such a program. In addition, if insurance premiums were capped at some "reasonably affordable" price, the incentive for individual companies to reduce or manage risk would be removed.

CONCLUSION

Because this period of turbulence and uncertainty is likely to continue for 18 months to two years or more, and may permanently affect some risks, I believe it is imperative for Congress to take action that will facilitate the ability of persons or organizations, whether they are businesses, municipal governments, nonprofit corporations or trade associations, to self-insure all of their general liability insurance risks and to purchase liability insurance on a group basis.

[The following information was subsequently received for the record:]

Questions of Senator Pressler and the Answers

Question 1. Is self-insurance available to everyone who wants it? If not, what other remedies are available to those who cannot self-insure?

Answer. As a practical matter, self-insurance is not available to every firm or organization which wants to use it. There are two reasons why it is unavailable as a practical matter for small businesses and small nonprofit organizations. First, small businesses and small organizations cannot set aside sufficient funds to pay large liability claims on a self-insured basis. Self-insurance in effect means no insurance at all and a company or organization must set aside sufficient funds to pay all expected losses under a self-insurance program. Because liability claims may reach or exceed $1 million, small organizations do not have sufficient money available to fund a fully self-insured liability insurance program. Second, in contrast to premiums paid to a commercial insurance company, money set aside in a self-insurance fund is not deductible as an ordinary business expense. For these reasons, as a practical matter self-insurance is not a feasible method of providing protection against the potential liability of small and mid-sized companies.

Question 2. Will expansion of the Risk Retention Act solve the problems currently faced by insurance buyers?

Answer. As stated in my testimony, expansion of the Risk Retention Act is not a panacea. It will not solve the insurance problems of all companies or organizations, and it will not address the underlying tort problem which requires the attention of Congress and state legislatures. Expansion of the Risk Retention Act will, however, provide an opportunity to small businesses and nonprofit organizations which are unable to obtain commercial liability insurance or find that the premiums offered by commercial liability insurance companies are unaffordable. A survey by the United States Chamber of Commerce indicated that 13% of its members who responded to its survey were unable to obtain liability insurance. The Insurance Services Office (an insurance industry statistical organization) indicated in a 1985 report that there would be a shortfall of some $50 billion between the amount of property casualty insurance business that could be written and the amount of property casualty insurance coverage that would be sought by American businesses. If this shortfall in capacity exists, and I believe it does, then some alternative means are necessary to permit businesses, nonprofit organizations and municipal governments to protect themselves against damages for liability claims. Group self-insurance programs authorized under the Risk Retention Act are a means through which these necessary insurance programs can be established.

Question 3. How many states currently have laws which inhibit or prohibit the formation of groups for the purpose of buying insurance?

Answer. I have not conducted any recent survey of state laws with respect to this question. In 1981, 22 states had statutes that prohibited selling liability insurance on a group basis, with an additional five states prohibiting such group sales by regulation. Some 35 states in 1981 regulated in some form or another the collective merchandising of property and casualty insurance. See S. Rep. No. 172, 97th Cong., 1st Sess. 17 (1981). These restrictions are accomplished through statutes known as fictitious group laws which typically provide:

> No insurer or any other person on behalf of any insurer shall make, offer to make, or permit any preference or distinction in casualty [liability] insurance as to form of policy, certificate, premium, rate, or conditions of insurance based upon membership of any person in any particular group, association, corporation or organization and shall not make the foregoing preferences available in any event based upon any fictitious grouping of persons, such fictitious grouping being hereby defined and declared to be any grouping by way of membership, contract, agreement or any other method or means.

The effect of these laws and regulations is to prohibit a trade association or other organization which has better loss experience from purchasing insurance on more favorable terms than are offered to other insurance buyers. In addition, these fictitious group laws prevent group purchasers from obtaining reduced premiums which result from the fact that one agent acts as the agent for the entire group and accepts a lower percentage commission for the single large group policy and because furnishing insurance on a group basis may reduce the administrative costs to the insurance company thereby making it possible to offer more favorable premiums.

These fictitious group laws and other similar regulations have no economic or regulatory justification. They discourage insurance buyers from forming group purchasing organizations because they prohibit such groups from obtaining insurance at lower prices. Restrictions on group insurance programs have been condemned by almost all insurance experts. See S. Kimball, and H. Dennenberg, Mass Marketing of Property and Liability Insurance (U.S. Dept. of Transportation 1970).

The CHAIRMAN. Ms. Ehrnman, I have a letter which was handed me this morning from Senator Inouye, and he says in the letter, "I am unable to attend this morning's hearings. However, I would like you to thank Ms. Ehrnman on my behalf for her testimony."

So I thank you on behalf of Senator Inouye, and I thank all of you on behalf of all of us.

Please proceed.

Ms. **Ehrnman**. Thank you. It is a pleasure to be here today, Mr. Chairman.

I am here representing Certified Nurse-Midwives across the country. Certified Nurse-Midwives are nurses with advanced education in maternal and child health. They care for normal, healthy women. They always work in clinical collaboration with physicians. They are legal in all 50 States. They have an outstanding record of providing quality health care. Fifty percent of the health care that they provide is to the poor of the United States, and most important for purposes of this discussion today they cannot provide this care without professional liability insurance.

Our written testimony chronicles the events of the last year in terms of our story of being unable to purchase, at any cost, professional liability insurance. Therefore, we have decided we would like to investigate forming our own mutual insurance company. It is fortunate that I am following Mr. Mullen because a lot of what we have been advised is very similar as he has described the problems in going forward.

I would like to just share a little bit of what we have learned in trying to form our own insurance company. There are immense regulatory problems. In fact, we had no idea when we started off on this that to get an insurance company license in all 50 States could take years, and years, and years. We do not have years.

This spring, from a survey of our membership, nurse-midwives will be totally without insurance and totally out of business. We need to get this insurance company up and running this spring. S. 2129, expanding the Risk Retention Act, certainly will help us, and we do support that bill with a few minor wording changes, which I will share with you in future comments.

Second, there are technical problems with forming your own insurance company. The one which I will just share a few words with you on today is the whole problem of occurrence policies versus claims-made policies. The gentleman from Lloyd's of London did explain from the insurer's point of view why they would prefer to switch everything to a claims-made policy, and why in fact you cannot get reinsurance at all unless you have a claims-made policy.

I would like to just explain for a few minutes why for nurse-midwives and other health care professionals this is so very difficult. Under an occurrence policy, which is how we have been insured for the last 11 years, if I were to deliver a baby this month and a claim were to come in in 10 years or 15 years and I were found negligent, the insurance company would pay that claim at that time.

However, under a claims-made policy, if I am insured this year from February 1986 to February 1987 and a claim comes in in 10 or 15 years, the insurance company will not pay, unless of course you have insurance from another insurance company, or if you are no longer insured and you purchase the "tail." The tail coverage is complicated. The length of time you can purchase a tail is complicated, and the amount of money which is being quoted for tail coverage is complicated.

It is a very difficult situation, and even in looking at forming your own insurance company, we too will probably have to offer a claims-made policy for, although we have no reinsurance yet because it is totally unavailable to us, we hope to get reinsurance. And the only way, we have been told, to get reinsurance is with a claims-made policy.

In summary, we are trying very hard to establish our own company. We are on a short timetable. We need to have this company up and running by this spring or early summer. The only possible way we can do that is by passing S. 2129 soon, within the next 2 or 3 months at the most, so that by establishing our company in one state it will automatically be licensed in all 50 States.

Thank you.

The CHAIRMAN. Thank you. Mr. Floyd.

[The statement follows:]

STATEMENT OF KAREN EHRNMAN, AMERICAN COLLEGE OF NURSE-MIDWIVES (ACNM)

Good morning. My name is Karen Ehrnman and I represent the American College of Nurse-Midwives (ACNM). I have been invited to share with you the difficulties which certified nurse-midwives have in obtaining professional liability insurance coverage.

This testimony will chronicle the extensive yet unsuccessful steps the College has taken on behalf of its members to obtain professional liability insurance. Additionally, I shall describe the obstacles resulting from the decision made by the College to study our options to assist nurse-midwives in establishing an independent mutual insurance company.

The impact of this situation on America's small business community in twofold: approximately one-third of our members are in private practice; another segment of our membership either owns or provides most of the health care in the nation's 140 birth centers. Until now, accredited birth centers have been a success story in the small business world. During the first three years of their operation, only eight to ten percent of these centers fail. By contrast, twelve centers have closed in 1985—largely as a result of an inability to obtain professional liability insurance.

As a result of the unavailability of insurance from the private sector, the establishment of an insurance company providing professional liability coverage is the only option available to nurse-midwives. Without this company, nurse-midwives will be forced to end their services to mothers and children across the United States. Birth centers will close and private practitioners will seek other livelihoods.

BACKGROUND ON ACNM

The American College of Nurse-Midwives (ACNM) is the professional organization for nationally certified nurse-midwives (CNMs) in the Untied States. There are approximately 2,500 members of the ACNM, representing close to 85% of the profession. A full 95% of the members carry some type of professional liability insurance coverage.

Certified nurse-midwives are highly trained health professionals. Educated in both nursing and midwifery, they are specialists in maternal and child health care. They are licensed in all fifty states and provide care to the healthy woman before, during and after childbirth. They are experts in normal gynecologic and family planning care. Each member of the College has been officially certified through a national written examination.

The nurse-midwives work in a variety of settings—such as private practices, university teaching hospitals, city hospitals, rural outreach centers, group health maintenance organizations, and health departments. Nurse-midwives deliver about three percent of the births in the United States. Approximately 75% of the births attended by certified nurse-midwives occur in hospitals, and another 15% occur in accredited birth centers.

Certified nurse-midwives work in clinical collaboration with physicians. ACNM standards require members to have an alliance agreement and health care protocols with a physician in order to practice. These agreements and protocols establish mechanisms for consultation and referral when complications arise.

ACNM also has reached a formal agreement out-lining acceptable guidelines for working relationships with the American College of Obstetricians and Gynecologists.

DETAILS OF THE CURRENT INSURANCE CRISIS

Since July, 1984, about 1400 CNMs have had professional liability insurance under a blanket ACNM policy written by the Mutual Fire, Marine and Inland Insurance Company. The remaining 1100 members of the College are insured by their employers—hospitals, health maintenance organizations, etc.

Mutual Fire notified ACNM in May, 1985 that the policy would not be renewed on July 1, 1985. ACNM's insurance was not renewed because of general conditions in the insurance industry—the unavailability of reinsurance—and not because of its members' professional performance. Suits have been filed against only six percent of all nurse-midwives—a number not considered high among medical professionals. By comparison, 66.9 percent of obstetricians have been sued at least once according to the American College of Obstetricians and Gynecologists. In addition to the non-renewal of the blanket policy, over 300 individual certificates of insurance were cancelled this past July. These cancellations accounted for all of the individual certificates of insurance written after December 31, 1984; the remaining 1100 policies expired by December, 1985.

HISTORY OF INSURANCE COVERAGE

Since the early 1970's, the American College of Nurse-Midwives has been able to obtain for its members a group policy that would pay up to one million dollars per claim. This one million dollar amount of insurance is the amount which many hospitals require nurse-midwives to purchase in order to qualify for hospital privileges. It is this amount of insurance we want to make available to our members today.

Mutual Fire Marine and Inland Insurance was the third insurance carrier the ACNM has worked with in the past three years. The change in companies has been the result of three separate situations: 1) the inadequacy of the premium rate charged by one company; 2) the second company's withdrawal from the medical malpractice market; and 3) the nonrenewal of the reinsurance treaties for our most recent policy.

STEPS TAKEN TO OBTAIN NEW INSURANCE POLICY

Early this year when ACNM received word that obtaining the master insurance policy might be difficult, we selected a "seasoned" broker with an excellent history of obtaining professional medical liability insurance. We believed that our broker understood what nurse-midwives are and that he would "market" us appropriately to the insurance industry. In search of a replacement for Mutual Fire we contacted 17 insurance companies in the Untied States. We were told that this represented most carriers in the U.S. who write professional liability insurance. We were turned down by all of these companies.

After these 17 formal rejections from major insurance companies, ACNM made personal appeals to several insurance company presidents. We did this for several reasons: to better inform them about the relatively low risk that certified nurse-midwives would place upon their companies; to understand their reason for not insuring nurse-midwives; and to be certain that our request for insurance had been given a full evaluation. The response was still "no".

The American College of Nurse-Midwives again wrote to each of these 17 company presidents asking them to reexamine the decision. Many of these letters went unanswered. The message was clear—no insurance.

Judging from the response we received from these insurance companies, we learned that many insurance companies had simply stopped writing malpractice policies. We also learned that within the speciality area of obstetrics, a crisis within a crisis was occuring. Insurers claim that the large premium increases which obstetricians and others are experiencing are necessary because of loss of profit resulting from unexpected large numbers of claims and skyrocketing awards. What was never actually said— but implied—was that the premium levels necessary to cover CNMs would be beyond the reach of professionals making an annual salary of $25,000. Therefore, they offered no coverage at all.

But consumer groups, such as the National Insurance Consumer Organization (NICO), have accused the insurance industry of using misleading statistics in claiming a loss in 1985. Instead, NICO suggests the insurers have earned $6.6 billion. The ACNM is not an insurance analyst; we do know that nurse-midwives are not part of the malpractice insurance problem because of our very low rate of suits. We believe that it would have been possible for an insurance company to write a policy for nurse-midwives at a reasonable rate and based upon sound actuarial data. In fact, as I shall discuss later in this testimony, our plan is to do just that—to establish an independent mutual insurance company which will underwrite CNMs at a reasonable rate.

STATE LEVEL INITIATIVES

Our next course of action was to send nurse-midwives to talk with professional liability insurance companies in their states. The response was still "no". Nurse-midwives talked to governors, state legislators, and state insurance commissioners. To date only one state out of fifty—New Jersey—has been able to offer insurance from a private carrier.

Still focusing at the state level, nurse-midwives investigated joint underwriting authority (JUA) and lobbied state legislators to extend joint underwriting authority to include nurse-midwives. We have been successful in implementing this in a number of states. However, for the most part, either the premiums for this coverage have been excessive or the amount of insurance offered has been less than required.

OTHER CONSIDERATIONS

As we evaluated the situation, nurse-midwives had little hope of obtaining affordable insurance from either the traditional insurers or the state JUAs. While these two options had been under consideration, the College's Board of Directors also commissioned a feasibility study on various options for self-insuring. Although this study indicated that it would be "feasible" for nurse-midwives to form an insurance company, the Board of Directors decided last summer that the insurance business was beyond the limited resources of nurse-midwives. The Board directed the staff of ACNM to look into working with other groups to self-insure or to join another group's self-insure program. The response to these inquiries was also "no", although ACNM continues to communicate with the American Nurses' Association (ANA) about forming a company for all nurses.

Another option involved asking Congress to consider establishing a nurse-midwife sponsored insurance program. At that time we had interested a primary insurer in writing the first layer of insurance coverage. That company would have written the first $100,000 of coverage and the federal government would have provided the excess coverage from $100,000 to one million dollars. Even as we discussed this with members of Congress, however, the primary insurer had a change of heart.

THE RE-EXAMINATION OF SELF-INSURE

Consideration of all of the options discussed up to this point utilized an enormous amount of resources. The process also strengthened the resolve of the leaders of the profession that searching for insurance could not become an annual event. Therefore the College's Board of Directors sought a second opinion on the self-insure options. This second evaluation confirmed the earlier one. In December, 1985, the Board of Directors decided to further study this option.

FORMING AN INSURANCE COMPANY

The emotion which accompanied the decision to study helping certified nurse-midwives form an independent mutual insurance company was short-lived. Even after hiring consultants and attorneys, the road blocks before us are enourmous.

Disregarding the very difficult financial problems, the following are some of the legal and technical complications which hinder the establishment of a company.

THE CLAIMS-MADE POLICY

One technical problem is the type of policy currently being written—a claims-made policy. In the past professionals have been able to purchase occurrence policies. There is a very important distinction between these two types of policies—a distinction which is critical to nurse-midwives as well as physicians.

An occurrence policy insures for all claims arising out of events which occurred during the covered period regardless of when the claim is filed. A claims-made policy insures only those claims which are filed during the policy year no matter when the event occurred. Does it matter? Yes.

For example, under an occurrence policy issued in February 1986 - February 1987, the nurse-midwife would be covered for any claim related to a delivery during this calendar year, even if the family did not file the claim until the child entered elementary school or even college. A claims-made policy, on the other hand, would only cover those claims filed during the February 86 - February 87 calendar year. To be covered for claims filed after this time period the professional must purchase "tail coverage". What further complicates all of this is that in this insurance market it is impossible to buy a "tail" for 21 years—the coverage that nurse-midwives and obstetricians need. In addition, insurance companies will not quote a price on a "tail" until it is needed, but we have been told it is likely to be two to three times the cost of a one year premium—and can be more. We have been told by the insurance industry that primary insurers are switching to claims-made policies because reinsurers will not write occurrence policies. Reinsurers argue that it is easier to anticipate costs with a claims-made policy.

REGULATORY ROADBLOCKS IN FORMING AN INSURANCE COMPANY

Simply stated, we have been informed by our legal counsel that under the insurance laws of virtually all of the states, a new insurance company could not write insurance unless it became licensed in each of these states. This is a costly and time-consuming process that takes several years—time we simply do not have. Also, the capital requirements of a few of the states exceed even our collective resources. Our legal counsel has reviewed the situation to see if exemptions from this licensing process exist, but none is available to us due to the number, size and geographic spread of our membership.

In 1981, Congress realized that this almost identical problem existed for small businessmen affected by the lack of product liability insurance, when it enacted the Risk Retention Act. This Act allowed groups of business to form risk retention groups to collectively insure the product liability risks of the members of the group without first becoming licensed as an insurer in any jurisdiction other than that of the domicile of the risk retention group itself. In 1985, Congress again realized that a similar problem existed when the House and the Senate passed an almost identical bill (which is part of the Super Fund legislation now before Congress) to provide for risk retention groups for environmental impairment liability insurance.

We ask you to provide us with the same type of legislation to permit formation of a risk retention group for professional liability insurance for nurse-midwives and birthing centers.

NURSE-MIDWIVES CURRENT STATUS: TEMPORARY INSURANCE COVERAGE

In considering practicing without insurance, most CNMs, as well as most physicians, feel both a moral and practical obligation to protect their patients and themselves from any unintentional human error. In addition, many CNMs must carry professional liability insurance to retain their employment and/or hospital privileges.

In an attempt to keep practicing, most of our members purchased insurance during this past year from one of two nursing groups whose policies did not include an exclusion of nurse-midwives. These organizations are the American Nurses' Association (ANA) and the Nurses' Association of the American College of Obstetricians and Gynecologists (NAACOG). The insurers of both of the groups have subsequently written into the policies exclusions of nurse-midwives. An informal survey of our membership indicates that this temporary coverage will begin to run out this spring and by next December no CNMs will have insurance if not provided by their employers or state JUA.

REQUESTED ACTIONS

I am certain you will agree with us that the formation of the insurance company over the next few months is critical. Congress can help. We urge Congress to : amend the 1981 Risk Retention Act; address the problem of the unavailability of reinsurance; and establish the availability of occurrence-type policies.

(1) Amend the 1981 Risk Retention Act: An expansion of this law to allow groups such as ours to establish an insurance company is essential. The idea we seek to implement is after meeting the requirements in a selected state for establishing the company, the company would be able to write insurance in all fifty states. This is the only way that we will be able to offer insurance to our members in all fifty states.

(2) Address the problem of reinsurance unavailability: Our problem began when Mutual Fire's reinsurance treaties were not renewed. Since then we have heard many insurers state that their capacity to write insurance is limited by the unavail-

ability of reinsurance. A new company also cannot get reinsurance and this substantially increases both short and long term financial risks.

In this regard, the American College of Nurse-Midwives urges you to make reinsurance available. This could be done by legislating the plan for federally-based reinsurance which has been drafted by the National Insurance Consumers Organization, investigating U.S. business practices and legislating changes to encourage the establishment of U.S. owned reinsurance companies.

(3) Make occurrence policies available: Nurse-midwives cannot purchase an occurrence policy. Additionally, in studying the possible formation of a new company, we have been advised that this company would also have to write a claims-made policy. The reason is that reinsurers will only reinsure the claim-made type policy. This situation must be changed.

Lastly, we need this assistance quickly. Although some private practices and birthing centers have already gone out of business, by spring the vast majority of these small businesses will be vulnerable. Thank you for your support and interest in this problem.

Mr. FLOYD. Thank you, Mr. Chairman, members of the Committee.

I am executive vice president of the Tennessee Municipal League Risk Management Pool of Nashville. I very much appreciate the opportunity to testify here today on the subject of public liability insurance and our operations as a public entity, a self-funded pool operation in general.

It is called generally the TML pool. It is a nonprofit public agency established under the laws of Tennessee in 1979. Its purpose is to manage the pooled risks of Tennessee municipalities. It was originally established primarily as an alternative to the commercial market which some of our more aggressive cities felt like was not serving some of their specific needs.

In particular, they wanted more aggressive loss prevention. They wanted a better sense of how their risks were being handled, and they saw the pool as an opportunity to provide this for them at the time. At that time it was not contemplated that the pool would be an insurer of last resort. We have approximately 340 incorporated municipalities in the State of Tennessee, plus a number of municipal entities which we will also insure such as housing authorities, utility districts, and special purpose operations of this nature which are extensions of municipal governments.

We have become, unfortunately, in the last 12 months the insurer of last resort for municipalities in Tennessee. This is a result of the collapse of the commercial market. We are now covering about 83 percent of the cities between 50,000 and 160,000. Of the remaining 17 or so percent, about half of those are self-insured. Some of those have retained their commercial coverage at relatively high rates.

We are providing right now general liability. This is sometimes called slip and fall liability for general municipal operations, public officials' errors and omissions, law enforcement, auto liability, and auto property damage coverage in our liability program. We also provide health and workers compensation.

We do not, incidentally, provide any pollution coverage. We do not feel that our pool is large enough to take that risk on, given the current court situation. We in effect do most of our services inhouse. Our claims operation for liability is done with staff personnel. We have a very aggressive and extensive loss prevention program that we also do with staff personnel. We have a very aggressive and highly orchestrated defense network, which is really composed of the better defense firms around Tennessee.

Incidentally, that is one of our principles. We use the best, and I should say most expensive, law firms in the State. You have to when you're dealing with the kinds of risks that we are contending with. We do use conventional insurance procedures for determining our risks, for determining our liabilities, and for keeping track of our total asset position.

We are not a cash-in/cash-out operation. We reserve for open claims. Obviously we count the paid claims, and we also try to establish very heavy reserves for incurred but reporting claims because of the long development time we have in this type of risk.

I think the major strength of our program is that we are a homogenous organization with a homogenous kind of constituency or clientel, however you wish to divide it. We are a public agency. We serve only municipalities. We can target specific services and programs to our clientel. I think our nontax and nonprofit status also helps us reduce overhead costs to keep them to a minimum. In fact, we sort of bill ourselves in Tennessee as the Chevrolet organization, a Celebrity with split seats, or a Caprice with vinyl seats, whichever you prefer. We are not a Cadillac organization neither in the terms we operate nor the type of coverage we provide.

Our major problem right now is that we are dealing with a growing and unpredictable exposure in both state and Federal courts, and I cannot overemphasize how dangerous that is. I would like to emphasize that we have no vested interest in high rates. We are operating basically on a break-even type approach to our program.

We get recognition based on how well we manage the risks and how low we can keep the dollar out. So we do not have a vested interest in high rates. I will tell you that the court situation that we are facing in Tennessee, which is relatively conservative, a middle-sized State in the South, is serious and it is growing more serious every day. That is part of the problem that we have to live with every day.

We see part of the problem, a major part of it, is the confused and ever changing interpretation of the application of civil rights to municipalities. I want to emphasize that we as a public agency are not opposed to using the Federal courts as an avenue of redress for minority groups and others who are denied basic civil rights. Some of the things we see do not involve civil rights that come through the system, and we think that there has got to be some kind of basic approach to that.

We also have to contend with the problem—a situation in the courts that seems to think that anybody that is injured as a result of any mishap of a major problem deserves to be compensated. We do not believe that is tort. That is victim compensation and there needs to be some other approach to that problem.

I guess there are a couple of other things that I had kicked in here that I would like to mention to give an idea of how serious our problems are. Our most serious problem is in law enforcement. We have seen about a 350-percent increase in the value of incurred loss in that area in the last 5 years, and the overall loss ratio in our law enforcement program is something over 400 percent.

Very briefly, there are two things I would like to mention in closing. We do think that we have to add our hue and cry—our voice to the hue and cry for tort reform. We think that probably the answer to the Federal tort system, or the Federal court system is going to be a codification of tort. I think that we also need some action at the local level and at the State level to improve our education of the public in general so that they understand better what the tort system is all about.

As far as Federal action is concerned, it would be helpful if we had some kind of mechanism which would make pooling easier, especially on a multi-State basis to allow domiciling nonprofit public entities for the purpose of providing pooling or reinsurance programs on a multi-State basis, which is very difficult at the present time.

Thank you.

The CHAIRMAN. Thank you, sir. Mr. Parker.

[The statement follows:]

STATEMENT OF JACK FLOYD, VICE PRESIDENT, TENNESSEE MUNICIPAL LEAGUE RISK MANAGEMENT

Mr. Chairman, my name is Jack Floyd, I am Executive Vice-President of the Tennessee Municipal League Risk Management Pool in Nashville, I very much appreciate the opportunity to testify before your committee today on the subject of Pubic Liability Insurance.

DESCRIPTION OF THE POOL

The TML Pool as it is called, is a non-profit public agency created under the laws of Tennessee in 1979. Its purpose is to manage the pooled risks of Tennessee municipalities. Our technical legal status is an instrumentality of local governments. State law authorizes the formation and creation of our organization.

We currently offer liability, worker's compensation, and health coverages to the 340 incorporated municipalities in Tennessee. Participation in our program is voluntary.

PUBLIC LIABILITY PROGRAMS

The first and largest program to be offered by the pool is a public liability program. A total of 245 cities and towns, housing authorities, and special purpose municipal entities participate in this program. We cover 83 percent of the cities and towns in Tennessee with populations between 1,500 and 60,000.

The programs include general liability, (sometimes described as "slip and fall" protection), public officials errors and omissions, law enforcement, auto liability, and auto property damage coverages. Current estimated earned premiums for the 1985/1986 fiscal year is $4.5 million.

SERVICE AND OPERATIONAL PROCEDURES

The Pool adjusts claims, manages its operations, and conducts an aggressive loss prevention program with an in-house staff of twelve. This staff is augmented by technical insurance and actuarial services purchased under contract from Public Risk Managers, Incorporated of Nashville, Tennessee and Tillinghast, Nelson, and Warren of Simsbury, Connecticut.

Legal defenses which is absolutely vital for our program, are accomplished through a network of highly qualified defense firms throughout the state, carefully coordinated by the Pool's General Counsel, Donelson, Stokes, and Bartholomew of Nashville.

The Pool's aggressive loss prevention program is heavily oriented towards law enforcement and administrative operations which gives rise to a growing number of costly suits.

We use conventional insurance accounting techniques in keeping track of assets and liabilities and assessing overall solvency. Our basic financial objective is to pay all current claims and overhead expenses, establish adequate reserves for reported open claims and incurred but not reported claims, and develop a cash reserve for contingencies equal to 10 to 15 percent of annual earned premium.

STRENGTHS AND PROBLEMS

The major strength of the Pool is its homogenous membership base. The fact that the Pool serves only municipalities allows us to target specialized loss prevention, claims, and legal services on very specific local government problems, such as jail suicides and police hot pursuit procedures. Our non-tax and non-profit status also helps reduce overhead costs to a minimum.

Our major problem is the growing and unpredictable exposure of local government to tort actions in both state and federal courts. While a pooled program such as ours can be a very efficient risk financing program if it is properly managed it still must respond to costs. Dollar outflow is, of course, directly related to the tort environment we live in.

THE PARTICULAR PROBLEMS WE SEE IN THE TORT SYSTEMS ARE

The confused and forever changing interpretation of the application of civil rights law to municipalities. Cities can be and are, sued for almost anything in federal courts.

The pervasive notion that anyone suffering severe injury or death are entitled to compensation, regardless of who is at fault.

Our system, no matter how efficient cannot eliminate incurred costs from these causes. The average value of incurred losses in law enforcement cases have risen about 350 percent in Tennessee during the past five years. Loss ratio's for law enforcement claims are over 400 percent. We are seeing similar but not quite so drastic a trend in auto liability. General liability and public officials errors and omissions have remained basically stable.

RECOMMENDATIONS FOR CHANGE

The TML Pool has to add its voice to the hue and cry for tort reform, although Tennessee local government tort law currently has a responsible, firm point of view. Our major concern is clear cut standards for the applications of civil rights law to municipal government operations. We do not advocate the repeal of Section 1983 of the U.S. code nor do we disagree with the philosophy that persons denied their civil rights because of race, sex, national origin, or religious belief should be denied access to federal courts for redress. We do believe that the current situations encourage allegations of civil rights violations which are not appropriate matters for federal court jurisdiction. We also believe that the problem is so confused that Congressional action will be necessary to redefine the courts jurisdiction.

Mr. **Parker**. Thank you for allowing me to appear this morning.

My name is Bruce Parker, and I am the general counsel for the National Solid Waste Management Association. What I would like to do this morning very briefly is just describe to you some efforts that the commercial hazardous waste industry has been taking to address the unavailability of comprehensive environment impairment liability insurance.

From November 1984, I started getting calls from general counsels and financial officers from some of our member companies telling me that they saw the handwriting on the wall because of the reduced interest rates, overall reduction in surpluses, and continued underwriting losses, it did not take a genius to figure out that something had to be done quickly.

Even more motivation was that toward the end of 1984, Congress passed the hazardous and solid waste amendments requiring that 1 year later companies had to certify for liability compliance under RCRA.

So with that framework in mind, a core group of our companies started holding meetings using my association, NSWMA, as an organizing tool to explore options and alternatives to solve the problem. We looked at Federal solutions, and essentially we dismissed them out of hand because we felt that, notwithstanding the fact that the Government has ventured into funding catastrophic losses in the past, other people here have testified as to what those programs are, that given the current fiscal problems the Congress would not be interested in pumping more money into the till.

Second, we also discussed very fleetingly perhaps a congressional inquiry, a top to bottom look at the insurance industry, again which people have suggested here. While I cannot speak for my industry personnally, I think that would be a very nonproductive exercise. I think it would be long term and the results would not be timely, if any results were there at all.

So what we decided to do was to take advantage of the pollution liability and Risk Retention Act amendments that Mike Mullen spoke about, which are presently pending in H.R. 2005, which is the Superfund amendments. I will talk about that later in conjunction with the bill that you gentlemen are introducing and sponsoring.

We decided that a mutual insurance company to self-insure our own risks was probably the most expedient and best way to go, because we felt as an industry we know what our risks are. We know how to manage those risks. And we felt we could capitalize it. We hired legal expertise, management expertise, actuarial expertise, and for 4 or 5 months we worked to put this program together.

The name of this proposed company—and I underscore "proposed 'because we have not accepted any applications yet; it is not fully capitalized yet, although we have everything raring to go—but the name of the proposed company will be Waste Insurance Liability Limited [WILL].

This will be open to people who are engaged in substantial waste management services in both the United States and Canada. I am sure the people in—I know Senator Gore in Tennessee, West Virginia, and Missouri, we have members in all those States, and hazardous and solid wastes are very prominent there, the management of it.

There are three minimum requirements. The first is that we have to have aggregate capital of $17 million with approximately 30 commitments. Second, we have to have compliance with all Federal regulations. There I am primarily talking about the Securities and Exchange regulations. And finally, we have to have the Risk Retention Act as presently in 2005 passed.

Our policy will be a claims-made policy, and we will be giving insurance on a $10 million per occurrence, and a $10 million annual aggregate basis, which is higher than that presently required by USEPA. There will be $1 million deductible involved with that.

To attract smaller companies who may not be able to afford that, or need that level of insurance, we have a second aspect where you can buy $6 million annual aggregate and $3 million per occurrence also with a $1 million deductible. This insurance will not be cheap. That is just the nature of the marketplace.

For the $10 million insurance, the minimum premium will be $100,000. For the lower-insurance level, the premium will be $50,000. And every single insured will be required to contribute 50 percent of their first annual year's premium as a capital contribution. Our program will cover all types of environmental risks: Leaking underground storage tanks, sudden and accidental as well as gradual which you cannot get now in the commercial market from whatever is available, which is a very limited capacity.

So we think we have a viable solution to our problem. But as I mentioned, the key to this is enactment of the pollution liability and Risk Retention Act. Why do I say that? Without that, we would have to go offshore. To go offshore, as Mike Mullen pointed out, to get licensed in all the States we would basically have to go hat-in-hand to every single State insurance commissioner and beg. That is just not going to happen.

The Risk Retention Act as contained in the Superfund amendments would allow us to get up and write very quickly, which brings me to the bill number sponsored by Senator Danforth, S. 2129.

We wholeheartedly endorse a generic amendment to the Risk Retention Act, but as I have indicated in my prepared testimony, and I have been taken over by events, we have one reservation. There is no question that environmental impairment liability insurance of all lines of insurance is just not there. If any line of insurance needs a Risk Retention Act fix, it is that.

I was traveling when I prepared my testimony about a week ago. When I left my office this morning, I had noticed that on February 28 I believe you actually introduced a bill to do this. Our reservation is that if in fact the Superfund Risk Retention Act fix should fail, we are concerned that EIL insurance might get caught up with some sort of protracted debate in your bill, and I do not think that would be productive.

But in talking with some insurance people this morning and other people present here, it seems that at least the insurance industry is reluctantly acquiescent to this Risk Retention Act fix, and we support it very greatly.

In conclusion, while we did not testify at the first leg of these hearings, I think it is sufficient to say that it would be very presumptuous of me to pinpoint with great exactitude what the causes of the present insurance crisis are. It is a confluence of many things. But I think the proof is definitely in that abuses in our tort reform system are clearly in some part responsible for it, notwithstanding what I heard here this morning about Canada, or Europe where there perhaps has not been a direct resultant decrease in insurance costs.

Intuitively I say that there is a certain lag time that you have to give before you see those costs. But we wholeheartedly support S. 1999 as we did S. 100 and S. 44, and we think that there is definitely a causal relationship between tort reform and the overall insurance crisis.

[The statement follows:]

STATEMENT OF BRUCE J. PARKER, GENERAL COUNSEL, NATIONAL SOLID WASTES MANAGEMENT ASSOCIATION

Good morning, Mr. Chairman and members of the Committee. My name is Bruce J. Parker, and I am General Counsel to the National Solid Wastes Management Association (NSWMA). The main focus of my presentation addresses a partial solution by commercial waste service firms to the current unavailability of environmental impairment liability insurance. Specifically, under the sponsorship of NSWMA, a number of waste service firms are in the process of establishing an industry-owned ("captive") insurance company to offer environmental impairment liability insurance. I underscored the word partial because addressing the root causes of the insurance crisis will involve a painful excursion into examining the allocation of risk in a complex society and the courage to make institutional changes justified by such an examination. I will expand on this point in my concluding remarks.

In short order, I will provide a fairly detailed description of the type of insurance the company will provide, eligibility requirements, and how it will be capitalized and managed. But first, I ask your indulgence for a few moments to provide some observations on the immediate and potentially long-term effects of the insurance crisis on the commercial waste service industry.

WASTE MANAGEMENT AND THE INSURANCE CRISIS

The causes of the insurance crisis are complex, the inquiry into which ultimately leads to difficult social, economic and legal questions about our society and its expectations. The range of responses and solution to the crisis are also complex, not only because of the first line of inquiry regarding from where these solution(s) should come, the public or private sector, but also because of the range of solutions within each sector, whether short or long-term and the positive and negative consequences associated with these choices. What is not so complex, however, is observing the effects the insurance crisis is having on the waste service industry and catching glimpses of what the future foreshadows should the crisis continue without any relief.

First, let's dispell the notion that some insurance capacity is still available in the commercial marketplace if only a firm "looks hard enough". Notwithstanding U.S. EPA's purported identification of eleven (11) commercial, primary insurers offering pollution coverage, full-time risk managers in our industry and, indeed, independent analysts within the insurance community report otherwise. These sources identify only two commercial organizations offering limited capacity for few select customers and under terms and conditions strictly dictated by these providers.

The fact is that some waste service facilities are closing because they cannot purchase insurance required by law. The U.S. EPA has reported that 48 hazardous waste disposal facilities failed to meet their financial responsibility certification requirements on November 18, 1985, simply because they could find no insurance and not for known environmental harms or noncompliance with environmental regulations.

Second, commercial waste treatment and disposal firms and transporters need sufficient insurance coverage not simply to comply with the financial liability requirements under the Resource Conservation and Recovery Act ("RCRA") and regulations pursuant to the federal Motor Carrier Act, but as a matter of prudent business practice. Candidly, satisfying minimum regulatory requirements is not the principal problem resulting from this insurance crunch, rather it is the serious inability of the commercial waste service industry to provide for bona fide risk transfer through insurance against catastrophic losses due to environmental occurrences. Plain and simple, our companies are talking about preservation of their asset base. Chief executive officers are being forced to make hard business decisions regarding future capital commitments to certain areas of operation in the absence of an available and financially competitive insurance market and, for obvious reasons, publicly-held waste service companies are under even more pressure to use insurance as an appropriate risk transfer vehicle.

Third, it is not unreasonable to speculate that this crisis situation could diminish the ability of professional waste service firms to provide services with a corresponding increase in public and environmental risk. As you know, eighty-four percent (84%) of all U.S. companies generating hazardous wastes are dependent for their waste management service on commercial companies. This excludes even more numerous "small quantity generators," few of whom have the ability to treat and dispose of their own wastes. Virtually all small quantity generators depend on our industry. Moreover, U.S. EPA constantly is expanding the universe of hazardous wastes, such as the recently proposed rule that would list used oil as a hazardous, a development that would further expand the universe of firms handling small quantities of wastes. The manufacturing segment of our economy to say nothing of of solid waste generators and haulers, are those whose existence now hangs partially, or fully, in the balance.

Fourth, the evaporation of pollution liability insurance and the uncertainty of general liability coverage not only threatens the RCRA program, but also the cleanup program of Superfund as well. The liabilities assumed by cleanup contractors and the facilities which may receive hazardous substances or wastes from spills or excavations are equally as uninsurable as those of treatment, storage and disposal facilities. To this end, NSWMA supports the provisions in H.R. 2008, the Superfund Amendments of 1985, that seek to indemnify these contractors. New Jersey recently enacted a law holding engineers and contractors cleaning up New Jersey's hazardous waste sites liable only for their own negligence. To my knowledge, New Jersey is the first state to pass such a law.

Last, I think it is important to appreciate and underscore that most informed regulators and industry analysts share a view that the disappearance of commercial pollution insurance is not tied to perceptions of increasing risks at hazardous waste facilities. Because technology is constantly improving in hazardous waste management, and provisions in the 1984 Hazardous and Solid Waste Amendments to RCRA are technology forcing, the current state-of-the-art is protective of human health and the environment.

In simple terms, it is the confluence of flaws in the insurance underwriting cycle, the collapse of domestic and foreign reinsurance support, and the unpredictability of our civil justice system that have placed the insurability of environmental risks on the endangered species list. So much for the effects of the crisis on the industry. I now turn to a potential solution.

THE SEARCH FOR A SOLUTION

In the closing months of 1984, the brutal reality of the deepening insurance crisis was apparent to many firms in the commercial waste service industry. Consequently, using NSWMA as a organizing resource, a group of firms began holding a series of meetings to discuss the situation and explore options. The inquiry was broad based and included both public and private alternatives.

At the federal level, the past three decades have witnessed commitment of federal funds to address potential catastrophic losses, such as through the Price-Anderson Act (nuclear), National Flood Insurance Program, Offshore Oil Pollution Compensation Fund, and the Urban Property Protection and Reinsurance Act of 1964.

Although Congress was becoming sensitive to the unavailability of pollution liability insurance and beginning to hold hearings, the group shared a belief that a federal venture into funding exposures for environmental risks was unlikely in the face of fiscal anxieties, and a serious Congressional inquiry into the structure of the insurance industry leading to reforms would be a lengthy process.

A state-by-state solution was dismissed as impractical. Indeed, it is only now that the states are beginning to seriously grapple with the insurance crisis through special legislative study commissions and bills aimed at generic tort reform.

In view of the above, our energies turned to an industry solution to our dilemma. And the vehicle we selected was an industry-owned, mutual insurance company.

A. The Mutual Concept: The pooling or sharing of risks has been a classic method of spreading and financing of losses among a group of riskbearers when insurance is either not available or is astronomically priced. The best example, of course, is Lloyds Coffehouse where shipowners traded segments of risk with each other. A more recent example is the formation of Oil Insurance Limited (OIL) in 1982, in Bermuda, as a result of an oil well blowout in the Santa Barbara Channel. Oil companies were faced with tremendous pollution liability exposures to which the commercial market would not respond. Thus, an original thirteen (13) oil companies formed (OIL) which subsequently has matured to more than forty (40) insureds, and today is extremely healthy financially.

Also, as a result of the severe medical malpractice difficulties in the 1970's, doctor and hospital organizations formed group captives, most of which are still operational and collectively write the majority of all such coverage in the United States.

B. "Where There is a Will—There is a Way": Convinced that the overall reduced surpluses, continued underwriting losses and reduced interest rates did not speak with optimism for the return of the commercial insurance market in the foreseeable future, NSWMA and a group of core companies (list attached) hired actuarial, management and legal expertise, to develop a proposed industry-owned, mutual insurance company to offer environmental impairment liability insurance. The primary purpose of this company is to offer insureds with catastrophic insurance protection for preservation of their assets, in addition to satisfying all regulatory financial liability requirements. Our long-term goal is to restore stability to the industry's insurance needs.

There are three basic preconditions before the proposed company will begin insurance operations. First, acceptance by the company of at least 30 commitments for participation with aggregate premiums of $17,000,000. Second, obtaining all necessary governmental approvals. Third, enactment of the federal "Pollution Liability Insurance and Risk Retention Act" as contained in H.R. 2005, the pending Superfund Amendments.

Membership in WILL will be available to any U.S. or Canadian for-profit entity with substantial commercial waste management operations, and which meets the financial responsibility and underwriting standards established by the company. In short, the universe of potential insureds are treatment, storage and disposal facilities, solid and hazardous waste transporters, sanitary landfill operators, and generators of hazardous waste who also engage in substantial commercial waste management.

Determining the threshold eligibility requirements for the proposed company involved understanding and accepting several key concepts. First, the common problem of unavailability of pollution liability insurance, does not necessarily involve a common solution. The nature of insurable risks, management philosophies, insurance needs, and other basic considerations are not uniform even within the commercial waste service industry—and the success of a mutual insurance company largely depends on a degree of homogeneity among the insureds.

A certain comfort level also must be reached to overcome inherent suspicions by each company that its loss experience and risk of loss is of superior quality in relation to other firms such that it would not benefit from participation in a mutual company and, indeed, might be disadvantaged economically as a result of other members' losses.

Second, there are factors that are unique to particular segments to those engaged in waste management that call for solutions shaped to that segment's particular needs. For example, participation of municipal facilities in an industry captive insurance company may be restricted not only by statutory limitations on the commitment of public funds, but by statutorily imposed exposures to liability different from and in addition to those common to others engaged in waste management.

Third, WILL's financial requirements have been developed without reinsurance at the present time, although the proposed company anticipates purchasing reinsurance when it becomes available. Reinsurance is an indispensable feature of any long-term captive program, in the absence of a reinsurance support also argued for a more conservative approach at this time. The availability of sufficient reinsurance not only would allow WILL to explore the possibility of broadening potential membership, but it also will provide flexibility to modify features of the program, such as policy limits, deductibles, financial commitments, and terms and conditions, some of which I will shortly describe.

As conceived, WILL will be a domestic mutual "captive" organized and domiciled in Vermont, and offering comprehensive environmental pollution liability insurance covering both "sudden and accidental" and gradual occurrences. The company will provide third-party coverage which means that the policy will pay for the amounts, subject to the policy limits, which the members are legally or contractually obligated to pay as a result of personal injury, property damage, or environmental impairment, each of which must occur off the insured's facility. First-party coverage, i.e., on-site remedial action costs, will be specifically excluded except for those incurred as directed by WILL to undertake remediation to prevent, avert, or mitigate third-party claims.

The policy will have limits of $10,000,000 per occurrence and annual aggregate, subject to a deductible of $1,000,000 per occurrence. To attract firms that may not need this level of coverage or cannot afford it, such as a single facility operator, sanitary landfill owner or hazardous waste transporter, the company will provide an option of purchasing coverage of $3,000,000 per occurrence and $6,000,000 annual aggregate also subject to the $1,000,000 deductible. In both cases, legal defense costs will be included in the policy limits.

Another flexible feature of the program is the opportunity for an insured to buy-down the deductible to $250,000 per occurrence on a pure financing basis. In other words, the insured would be obligated to repay losses and expenses that it incurred within this layer over a four-year period with interest payable at the end of each year.

The insurance will not be cheap but, then again, our intention is to provide catastrophic coverage and WILL will be without the benefit of reinsurance at the inception. There will be a minimum premium of $100,000 for $10,000,000 coverage per occurrence and annual aggregate, and a minimum premium of $50,000 for coverage of $3,000,000 per occurrence and $6,000,000 annual aggregate. In addition, each insured, regardless of the level of coverage selected, will be required to contribute a one-time capital contribution of fifty percent (50%) of the first year's premium.

Without reinsurance, the financial viability of the proposed company was based on very conservative economic modeling. This "worse case" approach was also necessitated by the absence of historical loss data on environmental impairment risks, a fact which the commercial insurance market circumvented during the frenzied years of cash-flow underwriting.

Two other funding features of the proposed company are noteworthy. First, in the event of a particularly bad year the proposed company will be authorized to call upon its insureds for payment of a Retrospective Adjustment to cover losses and their associated costs incurred by the company with respect to a policy year. This retrospective premium call is subject to reasonable limits and conditions which are intended to reduce its impact on an insured's earnings in a year in which the premium is called, but at the same time give the company flexibility to meet its lost payment obligations. Second, an insured's annual premium will be experience-rated for losses incurred in the previous year. In other words, a policyholder will be required to pay twenty percent (20%) of the amount reserved for future claims over a four-year period.

The foregoing discussion highlights and simplifies some of the many features of our proposed, industry-owned mutual insurance company. A "captive" has become a buzz word for a quick-fix industry solution to the insurance crisis. Trust me—nothing could be further from the truth. The formation of a captive, mutual insurance company is not a simple task. We have been at it for well over a year and only recently have we begun to unveil our proposed company to potential participants for the purpose of asking for financial commitments. We are optimistic that efforts will be successful, and we are looking at mid to late summer as a "go" date.

Forming a captive insurance company requires an understanding and working appreciation of the fact that each participant in the company will wear two hats: He will be an insured and therefore a co-financier of each and every other insured's risks, while at the same time an owner and manager of the company. Decisionmaking under this inherent tension must be balanced, generally through long negotiations, and differences resolved among the participants regarding the scope of policy coverage (operational exposures to be included, deductibles to be offered, expenses to be included), capitalization and funding requirements (are they fair to both large and small companies), and the need for a long-term facility to stabilize the industry's insurance needs (what is a reasonable period for both the insured and the company's needs regarding the commitment of capital and the term for insurance coverage).

On several points, however, there was unanimous agreement by the core group of waste service firms who have worked to give shape to WILL. First, meeting the threshold eligibility criteria for WILL is not a guarantee that the potential participant will qualify to become an insured. Each potential participant will be required to submit a detailed application to WILL and allow its facilities and operations to be assessed in accordance with comprehensive, environmental assessment standards established by WILL. Although WILL would establish these standards and requirements for the assessments, the actual assessments would be performed by independent assessors, approved by the company, who have been hired by individual members at their own expense.

Second, in contrast to the practices of commercial carriers who had written pollution liability coverage, WILL will scrupulously adhere to sound principles of underwriting, the critical process of risk selection and pricing. As with environmental assessments, the company through an underwriting committee will establish strict underwriting criteria which will be applied by an independent underwriter. In short, the company will underscore environmental assessments and auditing, underwriting and total risk management—goals of Congress, state regulators, and expectations of the public.

THE RISK RETENTION ACT

I mentioned earlier that enactment of the "Pollution Liability and Risk Retention Act" (the "Act") is one of the three preconditions to getting our proposed company up and running. I cannot overemphasize the importance of the Act. The Act is necessary for an industry-owned captive company whose insureds operate facilities in several states. Insurance companies are licensed under state law. If a company wants to insure environmental impairment liability risks of hazardous waste firms with multi-state operations, it would be required to obtain a license as an insurance company in each state in which facilities are located and operations are conducted. The Act would significantly simplify the regulation of self-insurance groups because a license would be required in only the state where the company was domiciled which would regulate the capital, surplus and management requirements of the company. However, the Act does give other states the power to act if the state of domicile declines or fails to exercise its regulatory responsibilities.

Mr. Chairman, it is my understanding that you announced on February 19 that the committee intends to introduce a bill amending the existing Risk Retention Act by extending its coverage beyond products liability.

NSWMA supports this effort, but at the same time has a reservation. We are concerned that any generic amendment to the Risk Retention Act should not threaten enactment of the "Pollution Liability and Risk Retention Act" currently pending as a noncontroversial provision in H.R. 2005, the Superfund Amendments. As you recognize, the very reason for the Risk Retention Act is to allow groups to self-insure for a line of coverage that clearly is not available in the commercial marketplace. While other lines of property and casualty insurance also are being unfavorably affected by the insurance crisis, there is absolutely no question that environmental impairment liability insurance is virtually unavailable. Although we are optimistic that Superfund will be reauthorized in the near future, should that not prove true, it would be counterproductive to have the immediate need for environmental impairment liability insurance held hostage in a predictably heated debate over a generic expansion of the Risk Retention Act. In fact, if the Superfund conference becomes protracted, we would suggest enactment of a separate—almost technical correction-type bill, different from a broad look at the need for expanding the Risk Retention Act into other lines of liability insurance.

CONCLUSION

I began my remarks by underscoring the fact that industry-owned captive insurance companies and other self-insuring arrangements are only partial solutions to the serious insurance crisis. If any Truth has emerged over the past year from the public debate over the causes of the crisis, it is this: the ills in the insurance industry, in large part, are manifestations of more systemic problems regarding the allocation of risk in an industrialized society. An allocation of risk ultimately leads to an examination of our civil justice system and whether its purpose is to allocate risk and base restitution on fault, or allocate the economic consequences of risk on some other model, such as one based on strict liability.

Mr. Chairman, my industry shares the widely-held view that the tort system needs to be readjusted to return to a traditional system of corrective justice based on restitution for fault. Corrective changes in the tort system, as you are well aware, undoubtedly will have a measurable, positive effect on stability in the commercial insurance market.

Virtually every state is now in the process of reviewing its tort system and suggesting reforms. Congress must assume responsibility and leadership for what is essentially a national problem. In recognition of the causal relationship between the unavailability of liability insurance and the urgent need for tort reform, you have sponsored S. 1999, product liability reform legislation. NSWMA and individual members have been very active in their support of predecessor bills on this subject, and we will continue to lend our support and comments during the debate on S. 1999.

In conclusion, the insurance crisis and its effect on the hazardous waste service industry has been a painful reminder of a host of questions, the answers to which ultimately will determine the long-term stability and future of hazardous waste services in this country: To what extent must the public, businesses, insurance companies and reinsurers, assume financial responsibility for risks inherent in providing the highest standard of living in an advanced society? How, if at all, should these risks be shared? And, perhaps most important, what role should the civil justice system play in responding to these questions?

The CHAIRMAN. Thank you. Mr. Stasch.

Mr. STASCH. Thank you, Mr. Chairman. I appreciate this opportunity to present my comments to this committee.

For the record, my name is Ronald Stasch, and I am the corporate risk manager for Federal Mogul Corp., a Michigan-based Fortune 500 manufacturer and distributor. I also serve as a member of the executive committee of the Risk and Insurance Management Society, which is commonly referred to as RIMS.

RIMS is a not-for-profit organization with a diversified membership of some 3,800 corporations, institutions, and governmental bodies. Our corporate members include 90 percent of the top Fortune 1,000 companies, but our membership also includes many smaller businesses, municipalities, and service organizations, all of which are commercial consumers in the insurance marketplace.

Copies of my complete written testimony have been submitted, and at this time I would like to highlight some of its contents.

Currently the property/casualty insurance marketplace can best be described as chaotic. All of the members of RIMS regardless of size or activity are reporting instances of cancellation and nonrenewal, insufficient limits of protection, staggering premium increases which are often multiples of expiring rates, and renewal terms which can best be described as grossly inadequate.

As a result, policyholders are paying more today and being covered less. In this connection, RIMS recently surveyed its membership as to their current experiences in the insurance marketplace. The final results of this survey will be given to this committee as soon as they are tabulated. However, preliminary results indicate few, if any, buyers of commercial insurance, regardless of size, and regardless of activity, have escaped the wrath of the hardening market.

An example of this can be shown by looking at the results indicated for just one line of coverage. Of the respondents who renewed directors and officers' liability policies, at the end of 1984—and that would be the period November, December, January—30 percent incurred premium increases of more than 100 percent.

For the same period at the end of 1985, the market had deteriorated to the point that the percentage of those which faced increases of more than 100 percent had risen to 80 percent of the respondents. As a part of that survey, we are trying to create a networking of various members to see who has a problem, in what area, and if they would be interested in getting together to form a risk retention type pool.

My written testimony goes on to offer a sampling of possible solutions to be considered. For example, the Federal Government can be instrumental in obtaining a commitment from the insurance industry to restore order to the marketplace. The industry enjoys an exemption from antitrust laws, and should therefore make an even more diligent effort to reduce these convulsive cycles and their negative impact on American commerce.

Also, the current U.S. Tax Code contains a tremendous bias in favor of the purchase of commercial insurance. Premium payments for commercial insurance are immediately tax deductible items, whereas the cost for a self-insured program is not immediately deductible, but must wait until some future time when claims and expenses are paid. RIMS encourages consideration of legislation that would provide a more fair and equitable treatment for self-insured programs.

Further, Congress should reject the proposed increase in the Federal excise tax on foreign reinsurance, since this is a cost paid directly by the policyholders who are already burdened by extraordinary premium increases, and it does nothing to relieve the shortage of capacity. Other areas mentioned are broad-based civil justice reform, and the feasibility of permitting banks into the field of insurance, all of which are supported by RIMS.

Finally, Congress should expand the concept of the Risk Retention Act to accommodate more than product liability.

On behalf of RIMS, I thank you for your time and attention.

[The statement follows:]

STATEMENT OF RONALD W. STASCH, VICE PRESIDENT—FINANCE, RISK AND INSURANCE MANAGEMENT SOCIETY, INC.

Mr. Chairman and members of the committee I thank you for this opportunity to share a few comments regarding a risk manager's view of the current and developing commercial property and casualty insurance marketplace. I am Ron Stasch, Corporate Risk Manager for the Federal-Mogul Corporation, an international distributor and manufacturer of a wide range of precision parts for the transportation, farm equipment, construction, manufacturing, and aerospace industries, headquartered in Southfield, Michigan. I am also a member of the Executive Committee of the Risk and Insurance Management Society (commonly referred to as RIMS) and serve as its current Vice President-Finance.

RIMS is a non-profit association for risk and insurance managers of commercial and industrial enterprises, public entities and service organizations. Our 3,800 organizational members, represented in more than 76 chapters throughout the United States and Canada, include not only 92% of the Fortune 500 list but many smaller businesses, towns and service organizations as well.

AVAILABILITY/AFFORDABILITY

In all frankness, the commercial property/casualty marketplace is chaotic. I do not know of any large commercial business that has not experienced cancellation and non-renewal notices; insufficient available limits and markets, premium increases that are often large multiples of expiring rates; and coverage that is grossly inadequate. Policyholders are left with a tremendous amount of risk that just a few short months ago was readily transferred to the insurance mechanism.

RIMS has recently surveyed our membership as to the current conditions in the insurance marketplace. Final results of this survey will be given to this committee as soon as the tabulations are completed. Preliminary survey results indicate that few commercial insurance purchasers, regardless of size or insured activity are immune from drastic premium increases or cutbacks in coverage. The situation has deteriorated rapidly since the inception of the so called "hard" market in 1984.

The preliminary survey results for two essential lines of coverage, Director's and Officers (D&O), and excess liability insurance, presents a bleak marketplace picture. D&O liability insurance protects directors and officers from liability claims arising out of alleged errors in judgement, breaches of duty, and other wrongful acts related to their organizational duties. Given the litigious nature of our society in this area, few directors and officers are willing to subject their personal assets to liability. It is therefore incumbent for an organization, be it a corporation, public entity, or charitable organization to secure D&O coverage if it wishes to keep or attract competent directors or officers.

Excess insurance in another vital line of coverage for the commercial insured. An excess insurance policy provide coverage over one or more similar primary coverages, which does not pay until the primary insurer has paid its limit for a particular loss. The importance to the policy-holder for excess insurance is basic—a catastrophic event with large losses may not be fully indemnified by the insured's primary carrier.

Of those survey respondents who renewed their D&O coverage in the period from November '84 to December 1985, 30% faced premium increases of more than 100%. In that same period a year later, 80% of the respondents faced premium increases of more than 100% of renewal. Premium hikes over 100% of renewal were even more prevalent for excess liability insurance. Sixty-five percent of all respondents renewing their excess insurance coverage from 11/84 to 1/85 had their premiums increased more than 100%. In that same period a year later, eighty one percent of the respondents had their premiums increased over 100% of the previous year's renewal.

Perhaps more ominously, concurrent with these large premium increases has been a drastic curtailment in coverage limits. Of those respondents renewing D&O liability coverage during the period of November '84 to January 85, 11% had their limits curtailed over 50%. In that same period, a year later, 30% of the respondents had their limits cut back over 50%.

To broaden the perspective, I would like to share the results of a third-quarter-excess-liability-renewal survey conducted in early November by a large national insurance broker, Marsh & McLennan, Inc. They asked their various United States offices to supply information on those large commercial clients which experienced excess liability renewals in the third quarter of 1985. The survey included participants—manufacturers, financial institutions, retailers, contractors, utilities, conglomerates, pharmaceuticals—representing a wide range of risks. The oil and energy industries were sparsely represented. The survey found 1985 limits to be only 41 percent of 1984 limits. The 1984 average cost per million dollars of coverage was $2,570 whereas the 1985 average cost per million had risen sharply to $23,260, an average increase of 805%. This survey does not attempt to measure the reduction in protection represented by the more restrictive 1985 policy conditions. In summary, the availability/affordability problem is real and widespread. The list of problem coverages increases weekly, affecting all sectors of our economy, whether large or small.

POTENTIAL IMPACT ON RIMS MEMBERS

These drastic price increases and coverage restrictions have far-reaching effects on american business and our membership.

First, and most obvious is the fact that without adequate levels of insurance, our members cannot operate their businesses prudently, cannot protect their growing asset bases nor offer ample security to their stockholders. The inadequate limits offered by the conventional marketplace, the prospect that many carriers do not have the ability to pay large losses, and the general operating plan of many insurers to accept only the most innocuous risks is simply unacceptable for our needs.

Second, many of our member firms rely on small suppliers of materials and services—such as waste disposal firms, motor truck carriers, and plant physicians—that are inadequately insured and could not react responsibly to losses arising from their products and services. Each week, we are faced to doing business with more and more vendors with insufficient insurance claims. Because our members are often the party "best able to pay", they are seriously exposed to liability risks resulting from their vendors' actions.

Third, we are faced with absorbing precipitious premium increases and potential uninsured losses which has serious implications in the competitive marketplace. The high cost of insuring in America can only add another burden to the nation's international trade problem.

The other potential implications most mentioned by RIMS members are these. There is a growing concern among businesses that as the potential for exposure to loss increases due to coverage and capacity curtailment, the potential for uncompensated American victims rises. And there are more and more instances of companies being forced to forego existing product lines, promising research projects or expansion plans in areas that represent high-risk potential.

RIMS is greatly concerned about the new claims-made Comprehensive General Liability (CGL) policy. Unlike many sectors of the insurance-carrier community, RIMS does not see it as a solution to the insurance availability problem. This CGL policy is the foundation of commercial insurance sold in the United States. For reasons explained more fully in the attached position paper, RIMs has grave reservations about the quality, scope, and continuity of coverage offered to the policyholder under the new CGL form. While RIMS hopes to be proven wrong about the efficacy of the claims-made CGL, we feel strongly that this policy reflects the failure of the current insurance marketplace. It is not a solution to the insurance availability crisis.

CAUSES

1. Cash flow underwriting: The industry is quick to point its finger to external causes of its woes. We agree external factors are there, however, we also believe that the fundamental problem lies in the industry's failure to better manage its affairs and to reduce the severity of the wide profit and loss cycles that plague the property/casualty industry in modern times. We think it was poor management which led to the cash-flow-underwriting and market-share mentality and the accompanying decline of underwriting skills.

We believe the industry when it reports underwriting losses for the years 1982-84 that amounted to more than $34 billion, surpassing the total of all losses for the previous 25 years. In fact, we are quite concerned whether the contingency reserves established by the industry are really sufficient to cover run-off liabilities. Perhaps they need to be further strengthened as the new round of price increases makes its way to the bottom line of the profit-and-loss statements. At this point, we believe that the industry could do much to improve its state by returning to basic risk-selection and pricing techniques by bringing those underwriters and actuaries out of the closet and by devoting the time required to write carefully worded, artful policies in order to reduce misinterpretation by the courts.

2. Civil justice system: Some have charged the insurance industry with withholding capacity in order to spur tort reform. The insurance industry is neither smart enough or stupid enough to adopt this tactic. Civil justice reform, while absolutely essential, is not something to be effected for the benefit of the insurance carrier. Insurance is simply a method of risk transfer which operates through the law of large numbers to broadly spread that risk. The insurance mechanism will not bail out a civil justice system that often expends more for court costs and legal fees than it compensates legitimate claimants. Nor is insurance the funding source of our emerging body of law that moves the role of tort law from one of equity to one which attempts to compensate all injury regardless of negligence. While the insurance companies may be the front line casualties of such a system of civil justice, they are not the ultimate losers. These losers are gynecologists who no longer practice obstetrics because of rising malpractice rates; local governments who cannot keep qualified public officials, because they cannot indemnify these individuals should they be sued; trucking companies who are making fewer runs because insurance is unavailable; businesses who turn away from promising areas of commerce and research because potential liability exposures are too great; asbestos victims who only receive a little more than 35 cents of every dollar expended in processing their claims through the present civil justice system; and every consumer of products and services in this nation who is ultimately shouldering the burden of our inequitable and inefficient civil justice system.

3. Effectiveness of State regulation: Many are taking this opportunity to designate inadequate state regulation as a major contributor to the recurring problem of the industry. For the most part, RIMS finds state regulatory personnel very capable, sincere and responsive to our members concerns. Many insurance related concerns are regional in nature and are best dealt with by a state mechanism. We do find, however, that most state regulatory bodies have a tremendous shortage of manpower and resources.

We have long been an advocate for returning a much larger share of the state insurance premium tax revenues (much of which we contribute as commercial consumers) to the State Insurance Department.

In the commercial area, regulation should focus on (1) the early detection of financial difficulties of individual companies, (2) enforcement of rules and laws against boycotts and other unfair trade practices and (3) the establishment of minimum standards of competence and conduct for insurance companies, agents, brokers and consultants.

SOLUTIONS

1. Continued congressional oversight: Anyone looking for a single quick-fix answer to the insurance availability crisis will be disappointed. The crisis we are in today is largely the result of years of insurance-carrier cash-flow underwriting and a civil justice system in need of reform. RIM's immediate concerns are of an insurance industry that currently seems to exploit, rather than remedy the present insurance marketplace chaos.

A good description of what is happening in many quarters of the marketplace was offered by Robert J. Clark, the Chairman of the Insurance Services Office, Inc. (ISO) and President, Commercial Insurance Division of Aetna Life and Casualty Company, before the Annual meeting of ISO, January 4, 1986:

"As important as it is for us to take the lead in civil justice reform, there are things I think we need to correct first within our own industry. If we don't correct them, we will lack the credibility we need to effect change in the outside world. I'm referring to certain actions some of us tend to take in a tight commercial market—such as cancelling policies mid-term; non renewing without adequate notice; raising prices to unreasonably high levels; cutting off classes of insurance without solid underwriting reasons; basing pricing and underwriting judgments on worse case scenarios; and just generally acting on fear rather than on fact.

I'm not suggesting that everyone has indulged in these excesses—or has done so to the same degree. But to the extent they are happening, I hope all of us—right here and now—will make a commitment to curb them."

RIMS hopes that insurance industry self restraint and the demonstrated concern of the state regulatory community will curb these excesses. Nevertheless, the numerous hearings held in Congress on insurance availability has had the salutory effect of reminding the industry that the McCarron Ferguson anti-trust exemption is a privilege, not a right, and while the federal government defers to the states in the regulation of insurance, it does not abdicate responsibility. RIMS firmly believes in the viability of state regulation of insurance. This viability is enhanced, not undermined, by continued Congressional hearings and supervision.

2. Civil justice reform: Our very general and brief concept of priorities on tort reform are these: Reform should be broad-based and give equal protection to all industries, not just selected sectors such as the medical profession or product manufacturers. The judicial reforms must be made to allow the escalating amounts of litigation to be processed with greater efficiency and lower cost.

The excesses encouraged by the contingency fee system must be curbed without causing unfair restriction to those sectors of society wishing to access our tort system. Realistic caps should be placed on non-economic damages. Punitive damages should be shifted from civil system to the criminal system where they can be more appropriately handed. It is time for statutory replacement of some of our original theories of negligence that in recent times have been cast aside by a system designed to remedy societal problems regardless of the defendant's fault.

As stated earlier, tort reform should be viewed as a long-term societal need, not just a quick fix for insurance unavailability. Nonetheless, the insurance industry should be expected to offer a commitment of coverage availability if civil justice reform is effectuated. To again quote Robert Clarke of Aetna:

"I've mentioned what might happen if we don't succeed in achieving reform. Even more important, I think, is what will happen if we do succeed. I believe it is absolutely critical that we make a commitment—both as an industry and as individual companies—that if we are successful in this endeavor, we will make insurance available for most, if not all of the areas where availability is currently a problem. We cannot—must not—use the availability issue as a reason to reform the civil system and then not respond when reforms are achieved. Are we willing to make that commitment? To me, this is the acid test of our worthiness to be the catalyst for change".

3. Congress should reject a tax hike on reinsurance ceded abroad: The House-passed tax reform bill contains a provision which hikes the tax on reinsurance ceded abroad from one to four percent. It must be understood that even before the current insurance capacity crunch, United States property casualty insurers reinsure much of the risks they assume abroad. The reality of the insurance transaction is that it will be the policyholder, not the insurer or reinsurer who will shoulder, directly or indirectly, the burden of this tax increase. It makes no sense to exacerbate the already rapidly escalating premiums by adding what is sure to be a 3% pass through cost. It makes even less sense to increase the transaction costs of international insurance dealings, when domestic insurance capacity is woefully inadequate to meet the needs of U.S. businesses, public entities and institutions.

4. Banks in insurance: The Insurance Services Office (ISO) has projected a $62 billion shortfall in commercial insurance capacity over the next five years. The entry of banks into insurance should not be viewed as a short-term fix to this capacity problem. There are many regulatory problems which must be resolved (For the record, a copy of the RIMS testimony before the New York State Temporary Commission on Banking, Insurance and Financial Services is enclosed). Unfortunately, the debate on both the federal and state level has seemed to focus on why banks should not be permitted to engage in insurance activities. RIMS respectfully submits that Congress and the states should now seriously consider what regulatory safeguards protecting market competitiveness, the banking consumer and the insurance policyholder would be needed to permit banks to lend much needed capacity to the insurance marketplace.

5. Congress should facilitate the formation of captive and risk retention groups: The purchase of insurance is only one of the ways in which the commercial insured can effectively deal with the risk of loss. If the insured is large enough and/or has a stable loss history, he/she may seek to establish a loss reserve to fund predictable future losses. This may be a far more efficient alternative for the entity than the purchase of commercial insurance. Similarly, a commercial insured may establish an insurance company subsidiary which exclusively handles the risk of the corporate parent. This subsidiary is called a captive. The captive alternative gives the corporate parent the added benefit of allowing it to tap into the often less expensive reinsurance market, normally available to only primary insurers. Often several insureds will come together to form a risk retention group. Unfortunately, conflicting

state insurance laws often make it most difficult for the insured, or insureds with multi-state operations, to utilize a captive. To quote from the legislative History of the Product Liability Risk Retention Act of 1981 (P.L. 97-45):

"The state laws have other regulatory standards which make it difficult for trade associations or small business groups to utilize them. For example one state's trade association captive must have an annual premium of over $1 million; it is subject to approval of its rates; it must establish that the insurance it provides is otherwise unaffordable or unavailable—price competition is not sufficient justification; it must be located in the state; and it would still be subject to the regulatory barriers imposed by other states for risk situated in those states.

Federal action is necessary because experience has shown that individual state legislation cannot facilitate the formation of self-insurance groups. Individual states can only enact legislation affecting their respective insurance law requirements. The practical effect of these laws is to prevent product sellers located in several states from forming such groups" Recognizing this problem, several years ago Congress passed the Risk Retention Act which facilitated captive formation for product liability risks. Recently, a similar amendment was included in the Superfund Reauthorization Act passed by the Senate. The amendment, would facilitate captive formation to insure pollution liability risks which the insurance industry has excluded from coverage in its CGL policy. RIMS suggests that such legislation should be implemented on an across-the-board basis and not just for pollution and product liability. We sincerely believe that captive formation can be facilitated without abridging legitimate state regulatory authority.

TAX EQUITY SHOULD BE AFFORDED ALTERNATIVE-RISK FINANCING MECHANISMS

A self insured using a loss reserve or captive-risk financing mechanism operates in a very similar fashion to a property-casualty insurer. Both employ actuaries or qualified loss reserve specialists who determine how much revenue needs to be set aside to fund future losses. The Tax Code permits the insurer to deduct the amount which it sets aside in a loss reserve to pay future losses. That same privilege is not extended to the self-insured who must often purchase commercial insurance at a much greater expense in order to receive the same tax treatment afforded to the insurer under the Tax Code. This Subcommittee recognizes the importance of encouraging a stable financing mechanism through which an entity can protect itself against future loss and through which claimants can receive just compensation. Yet under our present system of taxation, the emphasis is placed on whether insurance is purchased rather than the quality of the funding mechanism.

In the 98th Congress, Representative William Frenzel introduced H.R. 2642 which would permit a deduction for contributions made to certain self-insurance loss reserves and captive premium payments. Again in the interests of time, I am enclosing a copy of testimony which RIMS submitted to the Subcommittee on Oversight of the House Ways and Means Committee on this legislation. H.R. 2642 is even more important and timely in the present crisis, and we hope to see the legislation reintroduced in the near future. The passage of this bill would provide the corporate insured the desperately needed flexibility to survive in this era of insurance unavailability.

On behalf of the RIMS membership, I thank you for your kind attention and the opportunity to share our views. If you have any questions, please ask. Thank you.

The **CHAIRMAN**. Thank you, Mr. Stasch. Mr. Sigoloff.

Mr. **SIGOLOFF**. Mr. Chairman, members of the committee, my name is Allen L. Sigoloff. I am president and director of Camp Thunderbird, Inc., of St. Louis, MO. I am submitting testimony today on behalf of the American Camping Association, which represents a vast segment of the organized camping movement in the United States.

Since its inception in 1910, the association which is nationwide, nonprofit and nonsectarian has been committed to the continuation of the unique values and benefits derived from the organized camping experience. Over 4 million children participate in summer camps annually. These camps are resident and day camps. They are privately owned, socially sponsored, religiously affiliated, and some are institutionally sponsored. These camps cover and protect over 1 million acres of prime recreation land in the United States. We serve the elderly, we serve children from all walks of life, we serve those who are learning disabled, physically impaired, among others.

In Missouri there are approximately 260 camps contributing $60.1 million to the State's economy. Nationally there are approximately 11,200 camps contributing $4 billion to the U.S. economy. Unfortunately, all of this is threatened by the social and economic dependence on insurance. Many camps are finding or have found insurance to be unavailable or unaffordable.

For several years I have served on the American Camping Association Insurance Task Force to investigate alternatives and options to today's market. Our first attempt was to form a captive, because, in the late 1970's we began to experience sharp premium increases without relation to loss experience. Our attempt to form a captive failed because, although we were able to establish the startup funds, reinsurance was unavailable at reasonable rates because of a lack of a history of losses in the camping field.

We have been placed with other industries for rating purposes such as public liveries for horseback riding, boating and canoeing with marinas, lumped with other child servicing institutions with regard to child abuse and child molestation.

Our committee went back to the drawing boards and obtained bids for group insurance and found an agency to carry our insurance. It was our hope that we would develop a strong program, collect data regarding losses in the camping field, thus enabling us to form a captive of self-insurance program in the future. Although we are currently collecting the data needed, reinsurance still undermines our efforts.

The agency with whom we are currently working has experienced difficulty in establishing our program because the association's members are in all 50 States. Thus, we need to qualify our program in 50 States. We have been at this task for over 1 year.

In the past few years, insurance rates have increased from 50 to 600 percent. Horseback riding insurance, for example, has risen as high as $1,500 per head per season. At my particular camp, our insurance went up from $75 to $350 last year without notice. Many catastrophe umbrella liability policies impose a child abuse/molestation exclusion. Some policies specifically exclude activities such as water skiing, rock climbing, caving, rope climbing, travel, camping, and others.

Currently our agent has one primary carrier in our program. Recently one carrier who served the camping industry severed its relationship after 41 years, in spite of a favorable earnings record. Another company liquidated, having fallen victim to cash-flow underwriting.

Although we are still in the process of gathering statistics, preliminary figures show that 24 percent of our camps are considering closing because of increased premiums or unavailable coverage—32 percent of our camps are considering dropping key programs such as gymnastics and horseback riding and 16 percent of our camps have dropped programs because coverage is not available.

All of this has happened without serious losses, claims, or settlements to justify cancellation or increased costs. At this time, I would prefer not to rehash what has brought us to this point in the insurance crisis in the insurance industry in our country—tort abuse, contingency fees, insurance industry's mismanagement and misdirection and misregulation, coupled with the underutilization of comprehensive risk management have created the current situation.

The American Camping Association has initiated and developed a comprehensive and effective safety standards program for our affiliated camps. We see tort reform as being one answer to our current problem. It would be beneficial if the Federal Government would create incentives for the States to modify their tort laws.

Insurance regulations are another possibility. Expansion of the scope of the Risk Retention Act to cover for-profit and nonprofit service entities as well as other businesses and organizations will be extremely beneficial. This would enable the camping industry to start insuring programs with minimal cost and minimal startup time.

It would enable us to insure such areas as child abuse and child molestation. It would perhaps, allow us to insure activities considered to be high risk by the general public, but not by the camping industry because of our appropriate safety standards. The expansion of the Risk Retention Act will allow us to continue the fine tradition of organized camping, which celebrates its 125th anniversary as an institution in the United States this year.

Thank you.

[The statement follows:]

STATEMENT OF ALLEN SIGOLOFF, ON BEHALF OF THE AMERICAN CAMPING ASSOCIATION

Mr. Chairman, I have been asked to testify today on behalf of the American Camping Association because I have been a party to the Association's formal efforts, over the past several years, to secure affordable liability insurance for organized camps. I have served, and continue to serve, on the Association's Insurance Task Force, which has been charged with the responsibility of investigating alternatives and options in today's insurance marketplace.

Our Association represents a vast segment of the organized camping interests in the United States. Since its inception in 1910, the Association, a nationwide, nonprofit, nonsectarian organization, has been committed to the continuing values and benefits unique to the organized camp setting.

Over four million youngsters participate in summer camp yearly. They find diverse challenging activities in day camps and resident camps of many kinds—privately owned, social agency or religiously affiliated, institutional, and special purpose camps, covering and protecting more than a million acres of prime recreational land across the United States. The ACA works with many groups and professional organizations to assure camping's accessability to individuals of all ages, including the elderly, the economically disadvantaged, the learning disabled, and those with physical impairments, among others.

Unfortunately, all this is threatened by the development of social and economic dependence upon insurance. The inability to secure insurance—either due to unavailability or unaffordability—has obvious implications.

The insurance difficulties of organized camps transcend the distinct differences of the multitude of different types of camps and camping. It makes no difference if you are the small family owned operation, or the big city agency program, the effect is the same—erosion of important programs offerings, increases in participation fees, and most importantly a diminishment of the longstanding ability of organized camping to provide millions of children and adults the opportunity to participate in our unique programs.

Needless to say, the organized camps in this country have fallen victim to the current insurance trend. We most definitely share horror stories with other business sectors. The statistical trend is a major concern. While we are still in the process of developing comprehensive national data, preliminary statistics show that one quarter (24%) of camps are considering closing their doors because of markedly increased premiums or unavailable coverage. One third (32%) have dropped key programs (horseback riding, boating, repelling, ropes, gymnastics, etc.) because of premium increases. An additional one sixth (16%) have dropped key programs due to inability to find coverage. Indicators are that in the vast majority of cases, there are no serious losses, claims, or settlements to justify substantial premium increases.

The insurance trend, as it relates to camping, is actually a continuum of sharp premium increases experienced in the seventies. As is the case currently, those increases were incurred without relation to loss experiences. Ten years ago the National Board of the ACA established the Task Force, on which I serve, to examine the problems in the field and suggest alternatives. After a year or so of study, we recommended that a captive insurance company be formed. Initial approval was received, and a managing agency was retained to help with formation. Start up funds were secured, as were commitments from the necessary number of camp directors, but the plan was aborted when efforts to secure reinsurance at reasonable rates proved unsuccessful. The Association spent several thousand dollars before we were able to ascertain that reinsurance was unavailable at affordable prices.

Our major problem in securing reinsurance was the lack group loss history data in the camp field. This was largely the result of insurance industry practices of not rating camps based on independent group ratings, but rather on a host of a separate and largely unrelated risk codes. From a statistical standpoint, the result was an unavailability of a cohesive uniform group loss history. The Committee went back to the drawing board and entertained bids for standard group insurance with the hopes of developing a strong program, with heavy participation, through an agency that would assist in developing a history of losses.

That program commenced in 1982 with the Rhulen Agency of Monticello, N.Y. Given the fact that the Association has affiliated camps in all 50 states, obtaining standard group coverage posed difficulties. Because of separate qualification requirements for carriers in the several states, it took almost a year to set up that program.

Since that time, our Task Force has been meeting annually with agency principals to study losses and develop loss histories. We have been hopeful that this data will make forming a captive a more viable future alternative. Unfortunately, the state of the current reinsurance market is undermining these efforts.

In the interim, insurance rates have climbed from 50% to 600% in camps with no loss histories. Insurance on a single horse has risen as high as $1,500.00 for a summer season. Camps have been forced to sign child abuse waivers, sometimes retroactively under threat of immediate policy cancellation. And perhaps most ominous of all, the number of carriers willing to write organized camps through our established group program has steadily declined, to the point where we currently have only one carrier participating.

Given these developments, the Task Force has recently been charged with investigating self-funded or self-insurance programs as yet another alternative. We realize, however, that even with this option, we remain subject to the trends of the reinsurance marketplace.

What can be done to help alleviate the problem? We view the crisis—and we have had a decade to look at it—as essentially tripartite. Tort abuse, insurance industry mismanagement, misdirection and misregulation, and the under utilization of comprehensive risk management have all contributed significantly to the problem.

The order in which we have listed these joint causes is in no way indicative of their relative importance. In fact, if you look at the problem from the stand point of problem avoidance, versus problem resolution, the last cause, namely under utilization of comprehensive risk management, is of paramount importance. If we can better design a system to encourage accident avoidance, everyone except the plaintiff's attorney will win. In a climate where the insurance industry is sensitive to risk avoidance, you would think that risk management would be embraced with open arms. Yet getting experienced company risk managers to take a more active role is more often than not like pulling teeth. The situation has been exacerbated over the years by insurance carriers, who cut back on risk management staff and site inspections to minimize costs.

The American Camping Association has taken the initiative, and has developed a comprehensive and effective safety standards program for use by our affiliated camps. We strongly recommend that the Committee take a long hard look at how the insurance industry, and the private sector in general, handle risk management. Stronger incentives—other than fear of premium increases, which appear in any event to have little relation to loss history—are needed across the board. The old adage that an ounce of prevention is worth a pound of cure could not hold truer than here.

Tort reform is perhaps the most popular of proposed solutions to the insurance crisis, at least from the standpoint of the unprecedented expansion of civil litigation in this country. It is our experience that the expansion of litigation is largely regional. Many states throughout the country have actually experienced a reduction in the number of cases filed over the past several years, coupled with extremely conservative verdict histories. Yet premium increases are universal. It seems clear to us that many States are paying for the litigation arising under the laws of other jurisdictions.

Obviously the insurance crisis is not limited to regional sectors of the country. We are all sharing in the burden. This fact has led us to the conclusion that some degree of uniformity—and a tightening of the reins if you will—is in order with respect to our tort system. Eleven States have in their wisdom abandoned exemplary damages. Why then has a national movement to control excessive verdicts by limiting these damages been met with cries of foul, and declarations that this concept is totally foreign to our deep rooted system of civil justice?

Similar arguments can be advanced with respect to caps on pain and suffering, the inequity of joint and several liability, the double cost of the collateral source rule, the erosion of the doctrine of assumption of risk, and caps on lawyers' contingency fees. It is very important to note that these issues pose problems not only with respect to product liability, but with service industries, such as ours, and virtually every other entity, both profit and non-profit, engaged in commerce. A balance must be struck between the deterrent effect of our civil justice system, and the detrimental effect of generating an over reliance on litigation. We strongly encourage the Committee to take whatever steps necessary, whether through the use of incentives to the states or Federal preemptive powers, to restore some semblance of balance to the system of civil justice we all value.

Likewise, we believe Congress should explore potential avenues of Federal oversight with respect to wayward insurance industry practices. The power of Federal purse strings, when it comes to providing incentives for state regulatory enforcement, is available and should be used if necessary.

From the insurance industry standpoint, the most apparent contributor to the current crisis was an over dependence on investment income, and an under reliance on prudent underwriting practices. We question the desirability of permitting a reoccurrence of this practice if our goal is stability.

There remain a number of other industry practices worthy of review. Most agree that the claims history of individual establishments should play a more direct role in premium calculation. An analogy can be drawn between the unemployment compensation program, where individual business employment histories are tracked for purposes of premium calculation—and industry size, function, location, and other group factors are recognized as being largely irrelevant. Public policy should lend rewards—greater than that of simply not being sued—to establishments that implement safety programs with successful results.

A separate but related issue involves current rating systems which have a distorting effect upon true risk estimation. This is particularly so in the camping field, where insurer rating systems fail to recognize organized camps as independent risks. Camps are on the whole a heavily supervised, safety conscious industry, with a superlative loss ratio. Most camps, including those with American Camping Association accreditation, have comprehensive safety programs which form an integral part of their operation. Yet insurer standards assign ratings based upon a host of separate risk codes, too often totally independent of the camp situation. It is not uncommon for a small camp to be rated with major liveries if it has a horse, with restaurants if it has a kitchen, with timber companies to the extent it is located in the woods, and with marinas if it has a canoe. It is this very system which created our problem in obtaining reinsurance, as it does not lend itself to the development of adequate loss history statistics. The system to us is a prime example where insurance industry convenience has given way to unrepresentative and inadequate actuarial practice, at the cost of unnecessarily high premiums.

Lastly I would like to comment on state regulatory obstacles to group insurance plans, and the role of the Risk Retention Act. The difficulties posed by the multitude of state regulations should not be understated. The current system results in substantial delay and administrative costs, which are ultimately borne by the consumer. We applaud efforts to expand the scope of the Risk Retention Act to cover for-profit and non-profit service entities, as well as other businesses and organizations. The effect of such an expansion will minimize start-up time and costs, and provide more leverage to insureds. We believe that expansion of the Act will be especially helpful to entities whose liability insurance market has dried up completely.

Many businesses, associations, and entities are experiencing difficulty in obtaining insurance for specific liability risks which go to the heart of their individual program or function. General liability coverage, with broad and sometimes crippling exclusions, can pose as serious a problem as no coverage at all. In the organized camping situation, the improved ability to pool separate liability risks for which camps are having difficulty in securing coverage—such as horseback riding, gymnastics, boating, ropes, repelling, and the like—would also be of major assistance. For these reasons, we strongly suggest that any expansion of the Act apply to, and clearly and unequivocally permit, the pooling of separate and distinct risks. Expansion of the scope of the Act should not be in any way limited to situations where only comprehensive general "umbrella" liability coverage is sought.

SUMMARY AND CONCLUSION

Organized camping is an important adjunct to our society. Every year private independent and non-profit camps serve over four million youths, from all social and economic backgrounds, and contribute over $4 billion to the national economy. These contributions are at great risk by virtue of abuses of the civil tort system, insurance industry mismanagement and misregulation, and inadequate risk management programs.

Congress should use incentive legislation, or if necessary Federal preemptive powers, to make measured changes in tort liability standards and rules which address the entire system of commerce. Attention should not be limited to product liability, but should be extended to service industries, and all others similarly affected.

Congress should act on legislation to correct insurance mismanagement and ensure that those who create hazards share a greater burden of the cost. There should be protection for organizations with no significant loss history. Likewise, the diverse state regulatory burdens imposed on non-profit and for-profit organizations seeking to pool and secure group coverage should be eased through expansion of the Risk Retention Act. Such an expansion should clearly and unequivocally permit pooling for separate and distinct liability risks, as well as general "umbrella" liability coverage.

Lastly, the Congress should pay greater attention to problem avoidance and prevention, and consider substantial incentives for improved risk management programs.

The CHAIRMAN. Thank you very much, Mr. Sigoloff.

Mr. Mullen, were you in the room when the State insurance commissioner testified?

Mr. MULLEN. Yes, Senator, I was present.

The CHAIRMAN. Do you remember that they were asked about an expansion of the risk retention law and they raised questions about that saying that they were concerned that they were not going to have adequate authority to make sure that reserves were sufficient, and so on.

Do you have a response to that? Is their concern well taken?

Mr. MULLEN. Well, I have a response to it. I do not share that concern. You have to weigh first of all whether American citizens would be better off if you had camping organizations, or hazardous waste treatment companies with no insurance at all, or whether a modified regulatory system that can allow the creation of self-insurance groups with some insurance protection would be better.

I think it would be clearly better. But with respect to the specific concern about regulation, a risk retention group is licensed under State law and regulated by the State in which it is organized. What the State insurance regulators are really saying is they do not trust each other. They do not trust a group that is chartered in Colorado to have adequate reserves. They do not trust a group that is chartered in Vermont, which has a very good law, to be adequately regulated. Well, I have more faith in the regulators.

Second, the incentives within a self-insurance group are to make sure that it charges enough premiums, and that it has adequate reserves. Because if it does not, in the case of a corporation, it is putting its shareholders at risk, the shareholders of the member companies. In the case of a nonprofit organization, it is exposing the board of directors to personal liability, perhaps.

So I think that the groups that I have seen set up captive insurance companies conduct a very careful review with consulting actuaries and other persons and attorneys regarding what their exposure to liability is, and they try to fund those self-insurance groups at an adequate amount to make sure that they will be able to pay claims when they come due.

Third, the members of a risk retention group have much more control to assure that there are adequate premiums and reserves than people that purchase insurance from a commercial company. When you buy from a commercial company you do not know what other people the company is insuring who might have catastrophic risks that might put that company into bankruptcy.

I agree that a system of extensive regulation makes sense when you are trying to protect companies that sell to the public at large, but I think streamlined regulation that focuses and places the responsibility on the commissioner of the State in which the self-insurance group is organized will provide adequate protection for risk retention groups.

The CHAIRMAN. Just to summarize the testimony of the other witnesses—and you might want to add any comment that you have—but your view is, as I understand it as a group, that risk retention is very important to your line of work, or your undertaking. And that unless there is Federal preemption of State law so that you can do this on a national basis, it just is not workable. Is that right?

[Pause.]

The CHAIRMAN. Silence is an affirmation? Mr. Floyd, did you want to comment?

Mr. FLOYD. If I could make one point, I think there are a number of States, about 25 of them, that have had some success with the pooling on a statewide basis. To my knowledge, none of the pools have bellied up, the municipal pools I am talking about, have bellied up leaving any of the insureds——

The CHAIRMAN. But that is not, as far as you are concerned?

Mr. FLOYD [continuing]. The insureds not having their claims paid. There have been some difficulties, but nobody has been left without paid claims. The problem we are seeing right now is the need to tie these together on some kind of a nationwide basis, and in some cases I think to provide regional groups of smaller States. And that is very difficult under the current law.

The CHAIRMAN. Do you think this is an important bill, the Risk Retention bill? Or is it a minor addition to solving the problem? Mr. Sigoloff, you are my constituent, so I will look to you for an answer.

Mr. SIGOLOFF. The major problem we have had in the children's camping industry is that we have not been rated as an industry.

Therefore, we do not have any pure statistics. We are fairly sure that our loss record is significantly better than that which exists in the overall marketplace. The expansion of the Risk Retention Act would enable us to write insurance in areas where there is currently no insurance available, or insurance available at very high cost.

As I indicated in my testimony, a lot of camps are being forced to eliminate activities strictly because there is no longer the ability to insure them.

The **CHAIRMAN**. Thank you. Senator Rockefeller.

Senator **ROCKEFELLER**. I have no questions, Mr. Chairman. I would just express my gratitude to the panel for their approach to the bill, and also express my concern about the variety of problems they are going through.

The **CHAIRMAN**. Senator Gore.

Senator **GORE**. Thank you, Mr. Chairman. I will try to be brief.

I would like to also thank all the witnesses for coming, and in particular Mr. Jack Floyd of Tennessee. I would like to thank you for having him here as a witness, Mr. Chairman.

Mr. Floyd, you rearranged your schedule to be here, and we appreciate that. I have just a couple of quick questions. You mentioned that you do not cover environmental torts. Where do Tennessee cities get such coverage?

Mr. **FLOYD**. They do not, Senator.

Senator **GORE**. You also mentioned a problem you perceived with section 1983 of the Civil Rights Act. Now let me see if I understand this concern correctly.

You do not have any problem with liability under section 1983 for a police officer accused of brutality, for example? Your problem is the expansion of that section to cover automobile accidents, and other torts that were not really foremost in the minds of the authors when it was drafted? Do I understand that correctly?

Mr. **FLOYD**. Senator, brutality is a problem and, to some extent, if I could put it this way, if the brutality incident, and I know this gets very hazy, if it is simply an allegation that the officer used excessive force, I really think it ought to be handled in State court. Because every arrest involves some degree, or can involve some degree of force, and the question is is he going to tie every arrest up in the courts that occur under any circumstances. That sounds far fetched, but in some jurisdictions you get that kind of sensitivity in terms of claims.

We do not get a police-related death in the State of Tennessee, Senator, any longer that we do not get some kind of tort claim filed with it. I do not care what the circumstances are. I mean, I do not care what the circumstances are. We have got, out of about 20 police-related deaths right now, we have got one case that clearly involves the application of the Garner rule, which is the Supreme Court rule on the use of deadly force.

Incidentally, we think we can live with the Garner rule. We do not like it 100 percent, but we can live with it. The problems we have is, where do you draw the line? There are absolutely no standards for saying where you draw the line. We are in a floating crap game every time we get into a court situation with any civil rights allegation, especially involving law enforcement.

Senator Gore. All right. Now the unavailability of reinsurance of course is an integral part of this entire problem. What is the Tennessee Municipal League doing in conjunction with similar groups from other States to deal with the problem of obtaining reinsurance?

Mr. Floyd. First, we created our own reinsurance fund in the State of Tennessee for our program because we, just by dent of luck, began to smell a problem in the reinsurance market a couple of years ago. We were fortunate enough to create our own program, and at least to provide an interim financing of our upper level risk with our fund.

In addition to that, we are actively involved in the National League of Cities and about a dozen other States right now in attempting to set up a nationwide reinsurance program for municipal governments.

Senator Gore. Thank you. In the remaining minutes I have, Mr. Chairman, I would like to ask a couple of questions of Ms. Ehrnman. I have been very involved in issues affecting Certified Nurse-Midwives. I have a great respect for your profession and your organization. Indeed, last year I became involved in this particular problem to try to help you all find some reinsurance.

What I understand from your testimony here that is stated more clearly than by any other witness is that the legislation proposed must be passed quickly, or else the effect on your members will be rather devastating. Is what you are telling us that we need to get this bill out of the committee and passed on the floor by spring or early summer?

Ms. Ehrnman. Absolutely.

Senator Gore. Or else, as far as you are concerned, it will be too late. Is that basically what you are saying?

Ms. Ehrnman. That is right. It has taken us—we have been in this insurance situation since last May when we received notice that our policy would be nonrenewed in July. Systematically we have tried everything possible to obtain insurance. We really see forming our own insurance company as a last resort. If someone were to come up to me this afternoon and say, let us talk about insurance, I would say, good, let us talk.

However, it is a last resort. We feel we must go forward. It is only recently that we realized that it will take years under the current system to get it licensed in all 50 States. And if that is the situation, nurse-midwives will be out of business across the United States.

Senator Gore. Well, I would just note for the record, Mr. Chairman, that I think this is yet another example of the reinsurance industry being what I would call sloppy in the design of risk pools. The delivering of babies is the risk pool that has scared them. And yet, the difference between claims filed against obstetricians and claims filed against Certified Nurse-Midwives is rather startling.

Some 66⅔ of all obstetricians have claims filed against them. Only—what is the figure for Certified Nurse-Midwives?

Ms. Ehrnman. Only 6 percent have ever been sued.

Senator Gore. Only 6 percent of Certified Nurse-Midwives have claims filed against them. And yet, the reinsurers withdraw from the large pool of delivering babies and you, the nurse-midwives, are lumped in with the OB/GYNs who also have a terrible problem, but your problem is different. Because of your claims' record is different, you really should be treated differently.

The CHAIRMAN. That is a fascinating figure. What do you make of that number, Ms. Ehrnman? Either one of two things has happened. Either nurse-midwives do a better job of delivering babies than do obstetricians; or, obstetricians are viewed as the deep pocket. As a matter of fact, I was at the airport going out to the world series and I was nailed by a Missouri obstetrician saying that his liability insurance premium was over $100,000 a year. I was so concerned, I could hardly enjoy the World Series. But what is the reason for that? I guess they are the deep pocket. Is that it?

Ms. EHRNMAN. We share a lot of the problems with obstetricians. There are some differences, however, to be fair to the obstetricians in terms of the types of clients which Certified Nurse-Midwives care for, comparing them to obstetricians.

Certified Nurse-Midwives care only for normal, healthy women in a low-risk situation which, similar to what Senator Gore was saying, we have tried to market ourselves to the insurance industry as a low-risk group. Our claims data is excellent, and we care for only normal healthy women. So, we are a low risk, contrary to what the insurers believe.

Senator GORE. Mr. Chairman, if I may add to that response, it is also true that traditionally the Certified Nurse-Midwives have been much more heavily involved in prenatal nutrition, preventive measures to ensure that a healthy birth will take place. During that process the relationship between a Certified Nurse-Midwife and the pregnant mother becomes a little bit closer than that between pregnant mothers and obstetricians. And this may also serve as a deterrent to lawsuits.

Ms. EHRNMAN. Midwives go into the field with a strong sense of commitment to being with women during the childbearing years.

The CHAIRMAN. Maybe the women have sort of a close relationship with you and they are less likely to make claims. Is that possible?

Ms. EHRNMAN. We have been talking informally. There has never been a good research study which answers that. I am certain that the strong interpersonal relationship between Certified Nurse-Midwives and their clients add to that. We have also urged insurers to look at that with us. We think there is something to be learned from our excellent claims experience.

The CHAIRMAN. Thank you all very much for your testimony.

The final panel is Carole Rogin, National Association for Child Care Management; James Todd, M.D., American Medical Association; Assemblyman Chuck Hardwick, speaker of the general assembly of New Jersey, and chairman of the National Conference of State Legislatures' Government Operations and Regulation Committee; John J. Motley, National Federation of Independent Businesses; Stephen Hemphill, first assistant prosecuting attorney, Platte County, MO; and Paul Flanagan, President of the Raleigh County Commission, Raleigh, WV.

Thank you all for your patience in waiting so long today. What I would like to do is to ask Mr. Flanagan if he would testify first for the reason that Senator Rockefeller has another engagement, and I know that he would like to be here for your testimony, Mr. Flanagan, and also he would like to be able to question you before he has to leave.

So, if you could proceed, I would appreciate it.

STATEMENTS OF PAUL FLANAGAN, PRESIDENT OF THE RALEIGH COUNTY COMMISSION, RALEIGH, WV; CAROLE ROGIN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION FOR CHILD CARE MANAGEMENT, REPRESENTING THE AMERICAN TORT REFORM ASSOCIATION; JAMES S. TODD, M.D., SENIOR DEPUTY VICE PRESIDENT, AMERICAN MEDICAL ASSOCIATION; CHUCK HARDWICK, ASSEMBLYMAN, SPEAKER OF THE GENERAL ASSEMBLY, STATE OF NEW JERSEY, CHAIRMAN OF THE NATIONAL CONFERENCE ON STATE LEGISLATURES' GOVERNMENT OPERATIONS AND REGULATION COMMITTEE; JOHN J. MOTLEY, DIRECTOR OF FEDERAL LEGISLATION, NATIONAL FEDERATION OF INDEPENDENT BUSINESSES; AND STEPHEN R. HEMPHILL, FIRST ASSISTANT PROSECUTING ATTORNEY AND COUNTY COUNSEL, PLATTE COUNTY, PLATTE CITY, MO

Mr. FLANAGAN. Certainly. Thank you, Mr. Chairman, distinguished committee members, for inviting me here to discuss the liability crisis that local governments face today.

I would like to tell you about a recent insurance crisis in Raleigh County, WV. Last September we were notified that our insurance policy would be discontinued. Although we personally contacted numerous insurance companies, no one was interested in insuring Raleigh County. Every insurer assured us that our claims record had no bearing at all on our inability to obtain liability insurance coverage. As a matter of fact, over the 5 years that were reviewed, Raleigh County had only had two claims made, and very little payment toward those claims.

Despite all our efforts, Raleigh County, its employees, and its elected officials were left without insurance coverage. Of course we had to take immediate steps to limit the uninsured liability of the county. We were forced to order all outside agencies to cease operations in county-owned buildings. We transferred all of our jail inmates to another county's jail. We limited access to the courthouse itself to one handicap ramped entrance, and closed all recreational facilities.

Two weeks after we had lost coverage, we accepted a proposal from Fielding Reinsurance, a Turkish-based firm. Although we have $500,000 coverage today, potentially large problems still exist. Fielding Reinsurance is an excess and surplus lines insurance company, and therefore not accountable to our State insurance commissioner or governed by State laws. We can only hope that if and when a claim exists, they will be there to respond to that claim.

If this crisis is allowed to continue, the long-term effects on our county governments will be devastating. The number of competent honest citizens willing to subject their personal assets and families to huge liabilities will become smaller and smaller.

Senators, I beg you to harness this runaway monster now. Please do not wait until more local governments are casualties of this liability crisis. Act now to reform insurance and tort systems, and save the first line of government service in America. Thank you.

The CHAIRMAN. Senator Rockefeller.

Senator ROCKEFELLER. Thank you, Mr. Chairman. I want to thank Commissioner Flanagan and all the members of their panel for their patience. It is late in the day, and you are here on a very important mission in an extraordinarily difficult crisis which has arisen.

Commissioner Flanagan, Raleigh County is in fact a large county, is it not, in West Virginia? It is one of the larger counties?

Mr. FLANAGAN. Yes, we are fourth in population.

Senator ROCKEFELLER. And you have a budget in excess of $5 million a year?

Mr. FLANAGAN. Yes, sir.

Senator ROCKEFELLER. You have only had two claims in recent history, or in history, with respect to your previous insurance experience. Were either of those of a particularly serious nature?

Mr. FLANAGAN. We had one claim that amounted to about $1,200 paid for a young child who suffered a cut off of a merry-go-round in a recreational area. The other claim is for a fall on the courthouse steps, and that one has not been resolved.

Senator ROCKEFELLER. Other than that, you have a clean record, and yet your insurance was cut off. You found safe harbor with a Turkish firm, a Turkish-based firm. And yet, as you indicated, they are not regulated. They could pull out. They may not want to insure some of the things that are upcoming in Raleigh County.

Is the extension of this risk retention bill the best short-term cure that you can see for the problems of Raleigh County at this point?

Mr. FLANAGAN. Yes, I think it absolutely is. We obviously are working with the State legislature, Senator, and discussion has been held. West Virginia, as you previously mentioned, probably is too small to pool by itself, so we do need to be able to form larger than statewide pools to be able to assume those risks.

Senator ROCKEFELLER. If S. 2129 were passed, would it allow you to move swiftly to solve the problems that you have now, and the worries which you carry with you now as president of the county commission?

Mr. FLANAGAN. Yes, we certainly believe that it would.

Senator ROCKEFELLER. Would you probably have to form an insurance pool beyond the State of West Virginia? Or do you think it could be worked out in-State?

Mr. FLANAGAN. We certainly have not studied in-depth to determine whether it could be done in-State. We would look at that, and certainly would feel more comfortable than we are in the position we are now for two reasons.

No. 1 because of the Turkish base of the company and the volatileness that does occur sometimes in that part of the world; and also, because of the real low limit that we have, $500,000. Previously we were able to have $5,500,000.

Senator ROCKEFELLER. My final question. Has the State insurance commissioner been helpful to you? Or in fact have they really not been able to step in to help you?

Mr. FLANAGAN. I think I am particularly more aware of what has gone on in the last 1½ to 2 years. It is a problem that I guess most of us were caught off guard or were not really aware of the problem coming until it suddenly began to become a public issue probably about last July.

Up to this point in the current administration, there has been very little help from the State insurance commissioner, even to the point that the State legislators have asked for figures on profits, reserves, and investment incomes, and the State insurance commissioner has failed to provide those either by his choice or his inability to.

Senator ROCKEFELLER. But in any event, you just do not feel like waiting around for the State legislature to do something, even though you would like to see them do something; you would like to see this S. 2129 pass, because that can be of help to you.

Mr. FLANAGAN. Absolutely. I think it is imperative that it be passed, and I think that can be of the greatest help. Many State legislators meet for 60-day sessions once per year. That session will end this coming Saturday, and I really do not anticipate the passage of any significant help in this session.

Senator ROCKEFELLER. Commissioner Flanagan, I am grateful to you.

Mr. Chairman, I am grateful to you, too, sir.

The CHAIRMAN. Thank you, Senator Rockefeller.

Ms. Rogin, if you would proceed, please.

Ms. ROGIN. Thank you, Mr. Chairman, Senator Rockefeller.

I am Carole Rogin. I am here today in a dual capacity as executive director of the National Association for Child Care Management, which is the trade association of the private for-profit child care companies in the United States, and as vice president of the newly formed American Tort Reform Association.

As little as 6 months ago, I would have said child care and tort reform are a most unlikely pair, but today at least for the child care industry it is highly likely that tort reform may in fact be the key to its survival.

The American Tort Reform Association is a new broad-based coalition organized solely to address the issues of liability, availability of insurance, and reform of the tort system. Through the aggressive leadership of the American Consulting Engineers Council and James Coyne, their executive vice president, we now have 165 members that include professional societies and trade associations, the largest and like my association some of the very smallest.

The organization's charter members represent more than 96,000 businesses, professionals, communities, partnerships, and public entities. It is highly likely that many of them will be assisted by speedy passage of S. 2129. We applaud your introduction of this bill, and support it.

The wide range of businesses and interest groups that have joined ATRA have several concerns in common. As highlighted in my written testimony, first and foremost they have seen their access to adequate, affordable, and necessary insurance either severely curtailed or eliminated all together.

Second, members of our organization believe that the current insurance liability problems as related by many others here today are largely symptomatic of an underlying more basic problem of unbalanced litigation explosion. Today's civil justice system appears to be overloaded and fails to provide prompt, just, and full compensation to injured victims at a reasonable cost.

We feel that basic tort reform is the answer, together with a fundamental change in public attitude toward tort litigation. The agenda for our program mirrors these two basic concerns.

First, we are planning to develop a package of model reform proposals at the State and Federal level that will bring our civil justice system back into proper balance. Second, we intend to raise public awareness of how the current situation impacts on all Americans, and how the crisis must be resolved.

We intend to carry this effort to State capitals where liability, as others have identified today, is now the major issue across the country. We have received the support and encouragement of the current Attorney General of the United States, as well as members of the American Bar Association. Furthermore, ATRA's general counsel, former Attorney General Benjamin Civiletti, together with distinguished members of our legal policy committee are prepared to guide us in developing basic and comprehensive policy recommendations.

Let me emphasize here that I am not an attorney, and unfortunately Mr. Civiletti could not join me here today. But to the extent that you have specific questions about our recommendations as outlined in our written testimony, I would be pleased to have him respond in written form for the record.

Some of the elements that we are looking at currently include putting limits on liability, addressing the issue of punitive damages, revising comparative negligence, eliminating joint and several liability, and perhaps creating a mechanism for mandatory nonbinding arbitration of smaller claims, which currently make up the bulk of tort cases and are clogging the courts.

The challenge is before us. The past civil justice system as we know it has been eroded. We cannot continue to let this shift to a compensation-driven tort system expand and broaden, because paralleling these changes in the tort system there have been comparable changes in liability insurance.

With respect to my industry, the National Association for Child Care Management, its trade association, I think many examples have been brought forward today. For us, because we are a small industry with big visibility and an even bigger potential liability, because we care for America's children while their parents are at work, the issue is key to survival.

All of the industries and professions involved in ATRA look forward to working through the association to return to the basic American principles of fairness and equity. We believe in this effort that tort reform will be a key issue for consideration at both the state and Federal levels. We appreciate the opportunity to testify here before you this afternoon, and I would be pleased to answer any questions.

[The statement follows:]

STATEMENT OF CAROL M. ROGIN, EXECUTIVE DIRECTOR, NATIONAL ASSOCIATION FOR CHILD CARE MANAGEMENT AND VICE PRESIDENT, AMERICAN TORT REFORM ASSOCIATION

Mr. Chairman, members of the Commerce Committee, I am Carole Rogin, executive director of the National Association for Child Care Management (NACCM), representing the private, for profit child care companies that provide licensed center based child care services for children of working parents across the country. I am also here as a representative of the American Tort Reform Association (ATRA). NACCM is one of ATRA's charter members; I am ATRA's vice president and I will testify in that capacity before you today.

ATRA is a new, broad-based coalition organized solely to address the issues of liability, availability of insurance and reform of the tort system. The 165 members of ATRA include professional societies and trade associations, some of the largest and some of the smallest. The organization's charter members represent more than 960,000 businesses, professionals, schools, communities, partnerships and public entities.

Collectively, they employ more than 19 million tax paying Americans. We expect our membership to continue growing substantially, because the focus of our efforts — tort reform in the United States—may be key to the survival of businesses and professional practices.

The wide range of businesses and interest groups that have joined ATRA have several concerns in common. First, they have seen their access to adequate, affordable and necessary insurance coverage severely curtailed or eliminated. Consequently, these providers of essential goods and services to Americans across the country—whether it be child care providers, doctors, dentists, truckers, engineers, counties, towns—are caught in a liability trap. With insurance that has become not only expensive but, increasingly, unavailable, many providers of goods and services are now in the "risk business." The ideal that risk and liability must be in balance is disappearing from the current civil justice system. The system no longer provides a clear definition of liability, of who should recover because of another's fault. It encourages plaintiffs to sue, hampers defense, makes incredible monetary awards and has stretched the line that defines responsibility. If risk remains constant and liability continues to expand and broaden, the ability of the productive private sector to safeguard itself will continue to erode—resulting in a absolute cessation of vital activities ranging from obstetric medicine to toxic site clean up. Secondly, members of our organization believe that the current insurance liability problems are largely symptomatic of an underlying more basic problem of unbalanced litigation explosion. Today's civil justice system appears to be overloaded and fails to provide prompt, just and full compensation to injured victims at a reasonable cost. We feel that basic tort reform is the answer, together with a fundamental change in public attitude toward tort litigation.

The agenda for the ATRA Program is two pronged. First, we are building a broad-based bipartisan representation of public and private organizations with the resources and capability to demonstrate to our nation's policy makers what has to be done. In close liaison with key national and State decision makers and organizations, ATRA plans to develop a package of model reform proposals at the State and Federal level that will bring our civil justice system back into proper balance. Secondly, we intend to raise public awareness of how the current situation impacts on all Americans and how the crisis must be resolved. We intend to carry this effort to State capitals where liability is now the major issue across the country. We have received the support and encouragement of the current attorney general of the United States, as well as members of the American Bar Association. Furthermore, ATRA's general counsel, former Attorney General Benjamin Civiletti, together with distinguished members of our Legal Policy Committee, are prepared to guide us in developing basic and comprehensive policy recommendations. Although we are still developing specific aspects of our plan, there are several elements we may consider:

1. Put limits on liability: limit pain and suffering awards, particularly when there's no physical injury or when the injury occurred to someone else.

Reduce size of awards where the impact of taxes, expenses and collateral sources are significant.

2. Punitive damages: the original justification for punitive damages was to deter outrageous behavior, willful and wanton misconduct. In recent years, this good standard has been diluted to the point of capriciousness.

3. Revive comparative negligence: current practice allows plaintiffs to recover large damages even if they are more responsible for the injury than the defendant. This is what allows people who throw themselves in front of the subway trains to

recover hundreds of thousand of dollars from the taxpayers. It should be possible for judges to dismiss lawsuits at an early stage if the plaintiffs are clearly responsible.

4. Eliminate joint and several liability: the defendant should be financially responsible only for his own fault in the incident, and not for someone else's fault if the person can't pay.

5. Create a mechanism for mandatory, non-binding arbitration of smaller claims, which make up the bulk of tort cases. If a plaintiff then carries his case on to the courts, he should pay defense costs if he does not prevail.

The challenge is before us. The past civil justice system, as we knew it, has been eroded. We cannot continue to let the shift to a compensation driven tort system expand and broaden because, paralleling these changes in the tort system, there have been comparable changes in liability insurance. As the traditional defenses allowed in tort cases have been discarded, the insurance industry has found it far more difficult to predict expected losses and therefore to calculate risk. Everyone is paying the price. Consumers are paying for costlier goods and services and, in some cases can no longer obtain these vital services and goods. The producers just can no longer pay the price. The effect has been to inhibit technological creativity, deprive the average citizen of services, shut down many small businesses and disrupt normal activities of our society.

For the National Association for Child Care Management, the choice to participate in the formation of ATRA and to help achieve some tort reforms essential to our society was clear. NACCM member businesses operate professionally managed and staffed child care centers that care for, on average, 100 children at each center. These centers provide a licensed, safe and healthy program for children while their parents work and offer peace of mind and security for their working parents. If these centers cannot insure against the potential accidents of childhood, they cannot continue to operate.

The demise of professional child care will force millions of America's young children into underground, unlicensed and unsafe settings while their parents work. The impact will be devastating—on children, on their parents, and on worker productivity.

To illustrate the problem, one of our members paid $11,000 in 1984 to obtain $5 million of coverage for his small business of nine child care centers. In 1985, this very same business with a clean claim history is paying 5 times as much in premium dollars for ⅕ of the previous coverage, that also excludes some vital risk elements. In an industry with profit margins well below 5%, he can't finance this increase internally, nor can he increase tuition fees for a service that is already the fourth largest household expenditure. The only insurance this policy provides is the insurance that this business won't survive. I want to impress upon you the impact of these closings. Today over 60% of the mothers of children 18 years old and younger are in the workforce. That amazing percentage translates into approximately 36 million children in America who need child care for all or part of the work day. Over half of these children are cared for outside their own homes and this out of home care in the fastest growing segment of the child care industry. The need for care will not disappear, but the lack of available affordable insurance for child care centers will lead directly to no quality child care. The child care businesses believe we owe it to America's children to do better and solve this crisis.

We look forward to working through ATRA to do just that. Our goal is to return to the basic American principles of fairness and equity. In this effort, tort reform will certainly be an important issue for consideration by congressional leaders, administration officials, and State legislators across the country. I am pleased that the Senate Commerce Committee is actively beginning a careful investigation of the steps that must be taken.

On behalf of the American Tort Reform Association, I thank you for the opportunity to present our views today.

The **Chairman**. Thank you very much. Dr. Todd.

Dr. **Todd**. Thank you, Mr. Chairman.

Since our formal statement is on the record, and since I suspect you have already heard more about the liability problem than you want to know, I shall try to be brief.

It really gives me no great pleasure that the problems which for a long time have plagued the medical profession and, therefore, their patients—that is, high premiums and unavailability of insurance, are now plaguing business, municipalities, and virtually every sector of the economy.

I would like to talk to you this afternoon about the problem as I have seen it from three different vantage points. In speaking to you as a representative of the American Medical Association, I am speaking for hundreds of thousands of physicians in every type of practice across this Nation. But my views have been more focused and strengthened by two other hats that I have worn.

As a practicing surgeon, I have cared for patients and I have seen and experienced a worrisome change in that relationship as a result of the liability situation. I have also served as chairman of a physician-owned nonprofit malpractice insurance company trying to do something about the insurance problems.

Let me review very briefly some fundamental conclusions that we have gained from that experience. First, there is indeed a liability crisis, no matter what some people may say. It affects physicians by forcing legal issues into clinical decisionmaking. It changes practice patterns, not always for the better. Because of the expense and the psychological effects of professional liability, physicians are taking early retirement. A recent poll showed that 27 percent of physicians responding might well retire early.

Literally, the situation is forcing professionals out of their chosen profession, whether or not they may be culpable. Physicians are buffeted by dramatic increases in premiums for their insurance—44.8 percent in the last 2 years alone on average. Until now in New York a neurosurgeon will pay $100,000 in premium for only 1 million dollars' worth of coverage.

The crisis also affects patients. Perhaps because their preferred doctor has changed or limited their practices, as one-third of the obstetricians have done in Florida, or 50 percent of the orthopedic surgeons have done all across this country. Clearly the cost of liability premiums are passed on to patients. Beneficial high-risk procedures may be avoided or not even introduced because of the dangers and potential liability. And we hear a great deal about defensive medicine, which I believe is better defined as the objective validation of a clinical judgment in case a physician should find themselves in the courtroom.

This crisis also affects the Nation's pocketbook. Costs of medical professional liability alone are estimated at somewhere between $11 and $13 million per year, of which a significant amount is paid by the Federal Government.

Well, recognizing all of this, physicians themselves have tried to solve the problem by streamlining insurance mechanisms through the development of prompt settlement of deserving claims, stout defense of those that are not deserving, by producing risk-management programs to reduce the liability of physicians or its appearance, because after all 70 percent of the claims filed are without merit but are very expensive to defend.

And going one step farther than that, physicians themselves have formed their own insurance companies. And if the problem were solely in the insurance industry either in profiteering or poor management, we believed that physicians could forming it by solving their own nonprofit companies. Unfortunately, Mr. Chairman, our experience has paralleled that of all the commercial carriers.

Patient compensation funds and joint underwriting associations all across the country, run by State governments are also in trouble, and we fear the risk retention proposal before this committee would probably follow the same route.

Based on this, then, physicians have reached a conclusion that seems almost inescapable: That under current conditions it is futile to expect to find a solution to the liability problem through the insurance mechanism alone. We have fine-tuned the insurance mechanism as far as we can, and we still have a problem.

We believe that to achieve insurance stability, predictability, and affordability, there has to be a change in the tort system. The current tort system in this country is slow, inequitable, expensive, and has a lottery air to it, and does not really do what it was envisioned that it should.

Mr. Chairman, we endorse an approach of Federal incentives to States to assist them in passing tort reforms, as well as improvements in risk management and medical discipline. S. 1804 introduced by Senator Hatch and endorsed by some members of this committee would strike the right balance in giving Federal leadership on a problem of national proportions, while leaving States with the responsibility for final action.

It would bring rationality and predictability into our liability system without denying the right of any patient to seek fair compensation. Indeed, many of its provisions could be applied to the general liability issue, as well. In brief, this bill would encourage and reward States to enact certain tort reforms, and physician disciplinary procedure.

Our own actuaries predict that if this legislation were to be passed, we could anticipate a reduction of up to 28 percent in premiums alone, and incalculable savings in defensive medicine. Enactment of this legislation, in our view, would produce a more favorable climate in which to compensate injured patients, improve patient care, and preserve a healthy patient-physician relationship.

Thank you very much.

[The statement follows:]

STATEMENT OF JAMES S. TODD, M.D., AMERICAN MEDICAL ASSOCIATION

Mr Chairman and Members of the Committee: My name is James S. Todd, M.D. I am Senior Deputy Executive Vice President of the American Medical Association. With me today is Christopher A. Damon of the AMA's Department of Federal Legislation. The American Medical Association appreciates the invitation to testify on the medical professional liability crisis in the context of the overall liability situation in the United States today. We commend you, Mr. Chairman, and this committee for holding these hearings to highlight an increasingly important national problem.

Although our testimony today will focus on the crisis facing the medical profession, we are acutely aware that medical professional liability represents only one part of an overall liability problem in this country. Our situation is unique, however, in that this is not the first time that medicine has had a professional liability crisis. Moreover, we have been experiencing an increasingly negative litigation climate for over a decade.

The problem, ironically in a sense, stems from our desire to care for injured persons and to see justice done. Those of us in the profession of medicine, with its tradition of compassionate care for others, can readily identify with these motivations. The fundamental generosity and compassion of the American people have been reflected in recent years in a broadening of traditional negligence theory in an effort to compensate those injured even in cases where application of traditional negligence principles may not have resulted in damages.

Physicians are in favor of proper compensation and justice for those who are injured due to the negligent or wrongful conduct of another. This nation's civil tort system has been the channel through which justice and compensation have been obtained. We believe that the basic framework of our tort liability system has in the past worked reasonably well. It is not working well today. It has become an erratic, expensive and unfair system.

Our tort system has historically had it limits. It is not designed to compensate all maloccurrences. It requires that some named individual or entity be found responsible for the injury in order to justify compensation. "Acts of God" of injuries that are entirely the fault of the plaintiff are not intended to be compensable through the civil tort process. The system, clearly, is not intended to provide compensation for all injuries or maloccurrences.

In addition to the general expansion of negligence and other theories to provide greater degrees of injury compensation, the field of medicine has the added burden of meeting increasingly high expectations from patients and their families. No one can gainsay the astonishing progress we have made in this country in medical diagnosis and treatment with the concomitant decreases in infant mortality, increases in life expectancy and improvement in the quality of life of many through appropriate medical intervention. By every measure, the quality of medicine in this country has never been greater. However, an unfortunate side effect of these enormously beneficial developments has been the development of unrealistic expectations from patients. Medicine is not an exact science and a desired outcome cannot always be obtained—even when everything is done appropriately. This nation's more than 400,000 practicing physicians have the challenge of meeting the ever-increasing medical care expectations of 240 million Americans.

Physicians are on the cutting edge of the liability problem facing the nation. New legislative solutions developed could have initial application in the field of medical professional liability. Problems that we have already experienced with increasing severity are now being faced by others. It is our view that adoption of the legislative proposals which we advocate will lead the way towards efforts to prevent the general liability problem from worsening. Medicine, however, cannot wait for all the problems of liability to be addressed. We need action now and so we urge the Congress to deal promptly and effectively with the liability issue.

THE CURRENT MEDICAL PROFESSIONAL LIABILITY CRISIS

I would like to present this Committee with certain facts illustrating the gravity of the current medical professional liability crisis:

the number of malpractice claims brought against physicians in 1983 is roughly double the number of claims brought in the mid-1970s.

since the mid-1970s, the size of the average award against physicians has tripled, resulting in an average verdict of $338,463 in 1984. The number of million dollar judgments per year has more than tripled since 1980.

Premiums for physicians' professional liability insurance continue to rise dramatically. For all physicians, premiums have increased by 44.8% in the last two years alone and by 236% in the last decade. Average premiums for New York physicians have risen by 312% since 1975. Neurosurgeons in New York face premiums of over $100,000 a year.

Injured patients on average receive less than 30 cents of every premium dollar paid by physicians for professional liability insurance.

Because of the increasing numbers of claims and higher premiums, physicians are reacting by: retiring early; discontinuing medical practice; restricting their practice to low-risk procedures; choosing lower risk specialties for practice; and avoiding practice in localities where large numbers of medical professional liability suits are filed.

A recent survey by the American College of Obstetricians and Gynecologists found that the economic pressures of malpractice suits have forced 12.3 percent of those surveyed to drop obstetrics practice. Those surveyed reported an average annual premium of more than $20,000. In Florida, obstetricians and gynecologists pay as much as $92,500 per year in malpractice premiums.

A 1984 American College of Surgeons survey found that concerns over potential medical professional liability suits have influenced 38% of responding surgeons (50% of orthopedic surgeons) to refer more cases or to refuse to accept cases.

Physicians are also reacting to the professional liability crisis by practicing "defensive medicine", a practice which includes ordering additional tests and procedures primarily in anticipation of a possible lawsuit. Studies indicate that 70% of physicians surveyed practice some form of defensive medicine. While some "defensive medicine" is good, much of it is not, and it is expensive.

COSTS OF PROFESSIONAL LIABILITY

The professional liability crisis not only is having a detrimental impact on physician practices and patient access to quality medical care, it also represents a significant and growing segment of the nation's health care bill. The costs of medical professional liability totaled an estimated $11 to 13 billion in 1984. These estimates suggest that costs generated by the current liability system were responsible for between 14.5% and 17.5% of the $75.4 billion spent on physicians' services in the United States in 1984.

It has been estimated that if the reforms advocated by the AMA were adopted, the potential annual savings would be $800 million to $1 billion in premium costs alone. Huge additional savings would be achieved through the reduction of the practice of defensive medicine. The federal government, which pays for nearly 30% of the nation's total health care bill, would realize major savings.

FEDERAL INCENTIVES FOR STATE HEALTH CARE PROFESSIONAL LIABILITY REFORM

An AMA Special Task Force on Professional Liability and Insurance last year gathered data about the professional liability crisis and met with medical, legal and insurance experts. The Task Force's report constituted an action plan containing a series of recommendations in the educational, medical, legal, and legislative fields. With regard to legislation, the Task Force recommended federal incentive legislation to encourage the states to adopt substantive reforms to the tort system in order to alleviate the professional liability pressures while at the same time encouraging greater physician responsibility. This approach is intended to allow states, within general directions provided at the federal level, to develop tort reform proposals designed to meet each state's unique characteristics and needs. Out of these recommendations, an AMA draft bill was developed which formed the basis for S. 1804, a bill sponsored by Senators Hatch and Inouye and a number of other Senators.

S. 1804—The Federal Incentives for State Health Care Professional Liability Reform Act: S. 1804 would provide federal incentives for states to adopt professional liability reforms. A state would be eligible to receive federal grants if the following tort reforms are adopted by the state and made applicable to cases involving health care malpractice:

1. Mandatory periodic payments for awards of future damages exceeding $100,000.
2. Reductions in awards for compensation received from other sources (eliminating collateral source rule).
3. Limiting awards for non-economic damages to $250,000.
4. Limiting attorneys' fees to 40% of first $50,000 of any award, 33.33% of next $50,000, and 25% of next $100,000, and 10% of any further amounts in excess of $200,000.

These reforms are designed to attack the problem of windfalls and would leave the fault concepts and deterrence factors in the system.

In addition, to qualify for grants a state would have to adopt the following reforms:

1. Licensing fees from health care professionals would be allocated exclusively to the state agency responsible for disciplinary actions.
2. Hospitals would be required to have risk management systems.
3. Insurance companies in the state would be required to conduct risk management programs and require physician participation as a condition of maintaining insurance.
4. Insurance companies would be required to make data concerning malpractice awards available to state disciplinary agencies.
5. State law would have to provide for expanded and protected peer review activities by state health professional societies in conjunction with their respective disciplinary boards.

Experience in states which have enacted reforms in their tort systems has shown that reforms such as those called for in S. 1804 can reduce unnecessary expenditures related to professional liability claims while providing more rapid compensation for individuals.

Let me briefly examine each of the reforms.

Periodic payments for future damages.—Structured settlements with periodic payments for future damages over an injured claimant's lifetime, rather than a lump sum payment, should be required. Periodic payments are less expensive to finance and they assure that financial resources will be available to an injured person over time as needed. S. 1804 also provides that payments should end if a patient dies, thus eliminating "windfall" payouts to persons other than the injured person. Cases have been reported where multimillion dollar judgments have been awarded to cover lifetime expenses of parties who die soon after the award is granted. Estimated savings of 6% in professional liability premiums alone could be realized from this reform provision in S. 1804.

Elimination of collateral source rule.—The collateral source rule prohibits the introduction into evidence of any information about compensation a plaintiff may receive from sources other than the defendant. Therefore, plaintiffs may receive a double, triple or quadruple recovery for the same injury — one from an insurer or employer or other source, and one from the defendant. S. 1804 encourages states to eliminate this rule so that awards would be offset by the collateral source recovery. Amounts spent by the plaintiff to obtain the additional compensation (such as insurance premiums) would be offset against any deduction. Estimated professional liability premiums savings of 8% could be realized from this reform provision in S. 1804.

Limit on non-economic damages.—Pain and suffering, mental anguish, and loss of consortium are examples of non-economic damages. These damages are impossible to ascertain accurately, can be manipulated by emotion, and are inevitably subject to speculation. They are a primary cause of the grossly distorted awards in professional liability cases. Non-economic damages should be limited. S. 1804 would provide incentives for states to limit non-economic damages to $250,000 in health care malpractice cases. Punitive damages would also be subjected to this cap.

Estimated professional liability premium savings of 12% could be realized from this reform provision in S. 1804.

Restriction on attorneys' contingent fees.—The American Medical Association does not recommend abolition of the contingency fee system. However, a sliding scale for such fees should be established. Customarily, attorneys accept personal injury cases, as well as professional liability actions, on a contingent fee basis. The attorney may receive from 25% to 50% of any award eventually won. Injured patients on average receive less than 30¢ of every dollar paid by physicians for professional liability insurance. Moreover, two-thirds of claims are settled with no payment. This high rate of non-meritorious claims is in large part due to the contingency fee system. The disproportionate nature of the attorney's contingent fee is compounded by the fact that there is often no relationship between the size of such fee and the degree of complexity of the matter and amount of legal skill and time devoted to the case.

S. 1804 would encourage states to enact a sliding scale for such fees, with declining percentages paid to an attorney as the size of the award increases. This would help assure that the appropriate proportion—i.e., the bulk—of the award goes as compensation to the injured party, not to the lawyers. At the same time, because of the larger percentage at the lower end of the award scale, lawyers would still be encouraged to accept cases with lower anticipated judgments. This would not, as frequently charged, deny or restrict patient access to proper remedies.

The American Bar Association, in a report on a five-year study that was issued in August, 1984, found that when lawyers reduce the amount of time spent working on a lawsuit, the savings are passed on to clients only if the clients are paying an hourly rate. When lawyers work on a contingent fee, "lawyers are benefiting," not clients, the report said.

Estimated state savings of 9% could be realized from this reform provision in S. 1804.

Other reforms.—The AMA and the medical profession are committed to weeding out incompetence. We do not, however, view incompetent physicians as the cause of the current crisis concerning professional liability. The typical medical professional liability case involves a good physician being sued for the first time. Physician incompetency is an independent problem which we believe we have an obligation to address. Physician competency and discipline can be improved, but we need the tools. The process is already in place to conduct appropriate disciplinary activities, as seen in existing hospital peer review and quality assurance programs. However, greater resources are needed and anti-trust protection needs to be conferred.

Strengthening state licensing boards.—Most states have legislation which gives state health professional licensing boards effective investigative and disciplinary powers. However, these boards must have adequate resources to fulfill their functions. S. 1804 would require, as a condition of receipt of the federal grants established in the bill, (1) that states provide that licensing fees from health care professionals would be allocated to the state agency responsible for disciplinary actions and (2) that insurance companies be required to make data concerning malpractice awards available to state disciplinary agencies.

Risk management and peer review.—There is no evidence that the increase in the number of professional liability claims and the severity of awards are related to a decline in the quality of medical care in this country. To the contrary, the evidence is that the quality of care and skill of physicians have never been higher.

However, negligence does occur, and effective risk management and peer review can reduce it. S. 1804 would encourage states to require hospitals to have risk management systems and to require insurance companies in the state to conduct risk management programs and require physician participation as a condition of maintaining insurance.

In addition, state law would have to provide for expanded peer review activities by state medical societies. This provision in S. 1804 seeks to strengthen public and private efforts aimed at detection and discipline of physicians found to violate professional standards. The bill encourages states to provide their medical disciplinary boards with the authority to enter into agreements with the state and county medical societies to permit them to review any malpractice action, complaint or other information concerning the practice patterns of any physician. Any such agreement between the medical board and medical society would not be grounds for any civil or criminal action under the antitrust laws of the state or under federal antitrust laws. This is important, since in the past when medical societies have attempted to engage in peer review and discipline they have been subjected to lawsuits and liability for treble damages. Physician self-policing activities need to be protected and encouraged.

CONCLUSION

In closing, Mr. Chairman, I again commend you for your active interest in this critical issue as shown in your holding of this hearing.

The AMA strongly supports prompt passage of S. 1804. We believe that its enactment will assist in establishing a more rational professional liability compensation system that will achieve substantial savings to the health care system (including the federal and state governments) while maintaining patient access to high quality health care.

At this time I would be happy to answer questions from the committee.

[The following information was subsequently received for the record:]

QUESTIONS OF SENATOR PRESSLER AND THE ANSWERS

Question 1. "Do you support penalties for frivolous lawsuits as a means to reduce legal costs? What other specific tort reforms would you suggest?"

Answer. We support the imposition of penalties for frivolous suits, the establishment of minimum standards to sue, and facilitating the filing of physicians' countersuits. Various approaches have been developed to provide some restraint against frivolous claims and lawsuits, including filing notice of intent to sue, permitting a physician to recover costs in a frivolous suit, and eliminating the rule that a physician demonstrate "special injury" before that physician can countersue a plaintiff in a malicious prosecution action.

Other specific tort reforms that we would suggest are outlined at length in our formal statement which is a part of the record of the March 4 hearing. The major tort reforms which would be encouraged by S. 1804, a bill we support, are:

1. Mandatory periodic payments for awards of future damages exceeding $100,000.
2. Reductions in awards for compensation received from other sources (eliminating collateral source rule).
3. Limiting awards for non-economic damages to $250,000.
4. Limiting attorneys' fees to 40% of first $50,000 of any award, 33.33% of next $50,000, 25% of next $100,000, and 10% of any further amounts in excess of $200,000.

Question 2. "Do you expect that adoption of various tort reform measures will result in lower insurance premiums?"

Answer. Yes. The AMA retained an actuarial firm to estimate the amount of physician premiums that would be saved if all of the reforms we advocated in our draft federal legislation were to be adopted. These reforms are substantially similar to those called for in S. 1804. The actuarial study revealed that there would be potential annual savings of $800 million to $1 billion in premium costs, or roughly a 28% savings from current premium payments.

Question 3. "Are there steps professionals can or should take to police themselves more effectively, and thereby reduce legal costs and insurance premiums?"

Answer. The question links two separate issues. Yes, there are steps that physicians and other professionals can and should take to police themselves more effectively; S. 1804, which we support, would strengthen such activities. We have also developed model state legislation to improve procedures for physician discipline at the state level. A copy of that draft legislation is included. However, improved physician self-discipline, no matter how effective, will not alone significantly reduce legal costs, reduce insurance premiums, or alleviate other symptoms of the professional liability crisis. Tort reform is necessary.

Question 4. "What steps can or should the insurance industry take to smooth out the historical cycles that appear to cause such dislocation in the economy?"

Answer. We recognize that the insurance industry is subject to an intense business cycle and heavy competitive pressures. However, this cycle, which has primarily related to property and casualty lines of insurance, has never before resulted in a crisis of the magnitude now confronting medicine, as well as many other segments of the economy. The liability system has gone out of control and this has severely exacerbated the existing swings of the insurance industry cycle. We are concerned that some look to blame the current crisis on insurance companies as an alternative to addressing real problems in the tort system. In our view, insurers are reacting to the situation of unpredictably large risk in this country.

The CHAIRMAN. Thank you, Doctor. Assemblyman Hardwick.

Mr. HARDWICK. Thank you, Mr. Chairman.

I am Assemblyman Chuck Hardwick, speaker of the New Jersey General Assembly. I appear before you today on behalf of the National Conference of State Legislatures. I am chairman of the NCSL Government Operations Committee, which has responsibility for the issue which you are considering, the affordability and availability of liability insurance.

I appreciate the opportunity to appear before you today because the availability, the unavailability, and the cost of liability insurance is a national and even an international problem. State legislators are responding quickly and in a massive way to this crisis. Many States, including Maryland, Washington, Colorado, Michigan, have completed interim study reports, and others such as New York, Arizona, Texas, Illinois, currently have task forces or commissions or special study groups surveying the extent of the problem and weighing the potential impact of various proposed solutions.

NCSL has made liability insurance one of its top priorities. That is why today there are more than 1,200 pieces of legislation related to this issue pending in 43 State legislatures that are in session. Taken together, these bills present a wide array of potential solutions to the problems facing us.

Mr. Chairman, I brought with me a selected State summary for the members of your committee for their home States as to what their State legislatures are doing for your information.

Although insurance crises have occurred before, not one has reached the scope or magnitude of the crisis we face today. It is clear to us as State legislators that there are some fundamental problems in the property/casualty insurance business, and many of these problems you have heard about today and are referred to in my testimony.

Judging from our experience in New Jersey, as well as from information obtained by NCSL, it is clear that the causes of the crises are many. Whatever the reasons, however, a crisis carries with it serious implications for the economic vitality of New Jersey and every other State in the Nation. Skyrocketing premiums, combined with the increasing unavailability of liability insurance already have brought about the shutdown of some businesses resulting in lost jobs and lost opportunities.

Without expeditious resolution, the current liability insurance crisis could compromise the general economic health which has marked much of this decade. We believe that the crisis portends a profound inflationary impact, and consumers will ultimately pay for the cost of insurance. This situation reinforces our belief that we are not just dealing with a limited special interest, but rather a fundamental problem that goes to the heart of this Nation's economic vitality.

There are social implications, as well. As you have heard today, one of the sectors hardest hit by the liability insurance crisis has been the nonprofit corporation. Many good people who have served on the boards of these corporations have resigned because of an inability to secure insurance coverage. There is no reason for volunteers to expose themselves to such undue personal risk. The volunteer tradition is a strong one in this country, and is being undermined by the liability insurance crises.

Horror stories are being conveyed daily in New Jersey and elsewhere about liability problems affecting virtually every segment of society. As a result, private firms have gone out of business, professionals have left our State, and some persons have attempted to go without insurance entirely. But a public entity such as we heard from Raleigh County, of course, cannot go out of business or leave the State. It is forced to defend suits against it and pay any judgments that may be rendered.

Public entities are frequently named as minor parties in suits which have multiple defendants under the doctrine of joint and several liability. You are probably familiar with the Jackson Township case in New Jersey, which must be a material factor in any analysis of the deterioration of the municipal liability insurance market. It explains why insurers are concerned about their ultimate liability in view of what they perceive to be their heightened and increasingly unpredictable exposure to loss.

The current crisis demonstrates that the insurance industry does not have adequate underwriting data, particularly for excess liability coverage. One of our State regulators has suggested to me that the lack of adequate rate information and heavily publicized court awards have caused insurers to overreact and overestimate the potential exposure to future loss. As a consequence, their rating judgments may be more subjective than they should be.

New Jersey legislators have enacted statutes which permit counties, municipalities, and school boards to self-insure. They are also permitted to certain limitations to join together in regional insurance pools. This has worked well in our State.

I would suggest that States must reassess their regulatory framework for commercial insurance. In our State where we have deregulated, many people now think that that perhaps should be revisited.

If premiums are to be increased by insurers, they should justify the increases based on their experience in any given State. We are concerned in New Jersey, for example, that if we go with tort reform we do not have adequate data on a State-by-State basis, then it is a reduction in incentive for a state to have unilateral tort reform.

That is why I formed a new insurance committee investigation armed with subpoena power to undertake a review in our State of the insurance underwriting practices, as well as ratemaking procedures for commercial risk.

In conclusion, let me say—I see that we are out of time—that traditionally the regulation of the insurance industry has been the province of the States. I believe that the States have discharged their regulatory authority in this area in a responsible manner, and though this is a serious crisis we think the States are capable of solving it and Federal intervention is not yet called for.

Thank you, Mr. Chairman.

[The statement follows:]

Statement of Chuck Hardwick, Assemblyman, Speaker of the New Jersey General Assembly, on Behalf of the National Conference of State Legislatures

Good morning. I am Assemblyman Chuck Hardwick, Speaker of the New Jersey General Assembly. I appear before you today on behalf of the National Conference of State Legislatures. I am Chairman of the NCSL Government Operations and Regulation Committee which has jurisdiction over the matter before this committee today—the affordability and availability of liability insurance.

As most of you know, the National Conference of State Legislatures is the official representative of the nation's 7,461 state lawmakers. The organization provides the legislatures of all 50 states with basic issues research, technical assistance, comprehensive federal budget and funding data, and training services for legislators and their staffs. The NCSL also serves as the Washington, D.C. liaison for all state legislatures. The NSCL's State-Federal Assembly has adopted policies on a range of issues including liability insurance availability and affordability.

I appreciate the opportunity to appear before you today to share with you our concern with respect to the significant disruption which has occurred in the liability insurance market.

The unavailability and cost of liability insurance is a national and even international problem. State legislators are responding expeditiously to the crisis. Many states, including Maryland, Washington, Colorado and Michigan have completed interim study reports. Several others, including New York, Arizona, Texas and Illinois, currently have task forces, commissions or special study groups surveying the extent of the problem and weighing the potential impact of proposed solutions. NCSL has made liability insurance one of its top priorities and has published several reports (some of which have been previously shared with this committee's membership) and held several nationwide seminars and public meetings on the subject.

More than 1,200 pieces of legislation related to this issue are pending in the 43 state legislatures in session. Taken together, these bills present a wide array of potential solutions to the problems facing us.

CAUSES

One thing, must be kept in mind as we review potential solutions—insurance crises have occurred before. New Jersey is experiencing its third public entity liability crisis in the last 18 years. None have surpassed the scope or magnitude of the crisis we face today. It is clear there are some fundamental problems in the property-casualty insurance business. Some of the problems were apparently caused by "cash flow" underwriting.

It also has been suggested that certain underwriting practices in the reinsurance industry contributed significantly to the present situation. Insurers, on the other hand, blame an increasingly litigious society.

Judging from my own experience in New Jersey and from information obtained by NCSL, the causes of the crisis are many. In addition to cash flow underwriting and disappearing reinsurance, rising dollar losses from increased judicial settlements, substandard risk management analysis and skyrocketing premium increases are among other factors contributing to the current difficulties. Neither NCSL nor I have yet to come across the analysis which can easily and convincingly decipher which factor has caused what proportionate amount of the problem. Whether that report has been or will be written, I am bothered that government and small business are threatened with loss of insurance. They are, in some instances, utilizing more of already limited resources to remain insured while cutting operations.

Other suspected causes include:

Increased premiums regardless of claims history.

Loss or restriction of sovereign immunity.

Deficient safety practices resulting in unnecessary injury.

Unpredictable industry behavior.

Uncertainty regarding number and size of future claims and losses respectively.

Decline in return on insurance industry investments.

Undercapitalization of new entrants.

Costly transaction costs in tort litigation.

Fear of unmeasurable liability.

Joint and several liability.

Whatever the reasons, however, this crisis carries with it ominous implications for the economic vitality of New Jersey and every other state in this nation. Skyrocketing premiums combined with the increasing unavailability of liability insurance already have brought about the shutdown of some businesses resulting in lost jobs and lost opportunity. Without expeditious resolution, the current liability insurance could compromise the general economic health which has marked much of this decade.

The current crisis portends a profound inflationary impact. Consumers will ultimately pay the insurance tab. This situation reinforces my belief that we are not just dealing with a limited "special interest" crisis, but rather a fundamental problem that goes to the heart of this nation's economic vitality.

There are social complications as well. One of the sectors hardest hit by the liability insurance crisis has been the non-profit corporation. Persons who serve on the boards of these corporations have resigned because of inability to secure insurance coverage. There is no reason for volunteers to expose themselves to personal risk. The volunteer tradition is a strong one in this country and should not be undermined by the liability insurance crisis.

State legislatures have expanded the scope of potential liability and the courts have extended it further. Consequently, I am convinced that it is the responsibility of the states to ensure that insurance is readily available to protect the assets of those individuals upon whom this potential liability has been conferred.

SPECIFIC PROBLEMS FOR NEW JERSEY

New Jersey, like many other states, has experienced particular problems in the area of liquor law liability, professional liability, and liability coverage for public entities. I will provide some examples with which I am personally familiar.

West Orange, a suburban community outside our state's largest city of Newark, recently faced a situation in which the members of its police force refused to respond to any but emergency calls because the town was without liability coverage. Policemen feared that they would not be indemnified should a lawsuit be filed against their community.

In the small, oceanside community of Margate near Atlantic City, public officials recently faced the problems which many communities have experienced. Margate's insurance carrier raised its premiums sharply when the policy came up for its 1986 renewal and reduced the scope of coverage. In 1985, this town paid a premium of $65,000 for a $500,000 base liability policy and $22,000 for a $4.5 million umbrella liability policy. In 1986, the premium quote for the base policy nearly doubled to $120,000 and the quote for umbrella policy increased some 2000 percent to $242,850.

In addition to these huge increases, Margate officials were told that professional and public officials liability coverage would henceforth be excluded from the umbrella policy. Because the city could not afford to maintain its coverage at the previous levels, one of the city commissioners resigned. He feared that he would stand personally liable for his acts as a public official and that his coverage was inadequate.

Hamilton Township, another suburban community outside our State's capital city, experienced a premium increase from $195,000 to $1.8 million between 1985 and 1986. This kind of increase hardly seems justifiable when you understand that over the last six years Hamilton Township's insurer had to pay out only $350,000 in claims.

These examples are indicative of what is happening across our state and nation. A recent survey revealed that 30 percent of our state's municipalities lack any access to liability insurance coverage. Aside from the obvious budgetary catastrophe which would result from a large judgment against these communities, the lack of proper insurance coverage threatens their bond rating and credit worthiness. To the extent that a large number of municipalities in any state have inadequate coverage, there may even be fiscal ramifications for state government.

Similar horror stories are being conveyed daily about liability problems affecting virtually every segment of society. Day care centers, contractors, architects, engineers, doctors, and skating rink operators are but some of the affected parties. While the affected professions or businesses may vary from state to state, very few appear to be skirting the ramifications of unavailable or unaffordable liability insurance. As a result, private firms have gone out of business, professionals have left the state, and some persons have attempted to go without insurance entirely.

A public entity, of course, cannot go out of business or leave the state. It is forced to defend suits against it and pay any judgments that may be rendered. Public entities are frequently named as minor parties in suits which have multiple defendants under the doctrine of joint and several liability. This most frequently happens in automobile accident cases where the principal defendant has only the minimum limits of liability coverage.

New Jersey municipalities also have had to bear the burden of liability for hazardous waste sites and environmental problems. Towns and counties have been enormously affected by the courts' expansion of tort liability in cases involving pollution. In many cases, insurers have insisted on pollution exclusion provision in their policies, leaving towns and counties exposed to possible catastrophic losses.

In a landmark case, *Jackson Township* v. *Hartford Accident and Indemnity*, the pollution exclusion clause in an insurance policy was held inapplicable and this New Jersey township was indemnified by the carriers. While the judgment was later modified by the courts, that case increased insurers' anxiety that they would ultimately be held liable for catastrophic claims not anticipated when the insurance policies were originally written. The *Jackson Township* case must be a material factor in any analysis of the deterioration of the municipal liability insurance market. It poignantly explains why insurers are concerned about their ultimate liability in view of what they perceive to be their heightened and increasingly unpredictable exposure to loss.

The current crisis demonstrates that the insurance industry does not have adequate underwriting data, particularly for excess liability coverage. One of our regulators has suggested to me that the lack of adequate rate information and heavily publicized court awards have caused insurers to overreact and overestimate their potential exposure to future loss. As a consequence, their rating judgments may be more subjective than they should be.

An example of this point is seen in the dramatic increases in cost and availability of excess umbrella liability coverage despite the fact that New Jersey's communities have good safety and claims records. A recent survey identified only three claims paid or reserved over $500,000 in the last six years in my state. These claims totaled about $8 million or approximately $1.5 million per year. Nonetheless, excess liability coverage is costing New Jersey municipalities a staggering $42 million in premiums in 1986.

Thus far I have emphasized our experience in New Jersey. Virtually every state is experiencing similar situations. I believe this crisis must be and will be expeditiously resolved by the states. At this point, I would like to share with you some ideas about what can be done.

POTENTIAL REMEDIES

New Jersey's legislators previously enacted statutes which permit counties, municipalities and school boards to self-insure. They are also permitted, subject to certain limitations, to join together in regional insurance pools. This has reduced the cost of insurance significantly for some public entities because they are paying only for their own loss experience. One municipal joint insurance pool consisting of 39 communities has reported savings of 40 percent on their annual insurance costs. Let me say that these pools can only be effective, however, if they are established by professional risk managers and managed prudently. This is not a panacea, but it does provide at least an alternative to carrying commercial insurance. At least nine other states, including Arkansas, Florida, Illinois, Louisiana, Michigan, Minnesota, Ohio, Tennessee and Texas, have done the same.

I would suggest that states must reassess their regulatory framework for commercial insurance. In 1982, for example, New Jersey deregulated commercial insurance. Insurers were allowed to charge premiums for coverage without first seeking approval from the regulatory authorities. Deregulation, however, did not eliminate the statutory mandate, enforceable by the Commissioner of Insurance, that rates may not be excessive, inadequate, or unfairly discriminatory. It has been frequently suggested that in the aftermath of commercial deregulation many insurers charged inadequate rates because of the pressure of competition in the marketplace. As a result, they ultimately suffered heavy underwriting losses which depleted their surpluses and reduced their capacity to write new business. While I am not necessarily in favor of reinstating prior approval for commercial insurance, I do believe that states must place greater emphasis on monitoring the commercial insurance market so that insurers are not permitted to act in an irresponsible or imprudent manner.

Similarly, I think that the present crisis dictates that we take a new approach in mandating that insurers collect their statistics and formulate their rates based on their loss experience in any given state. At present, it is extremely difficult to get accurate data on loss experience for any particular line of insurance in a single state.

If premiums are to be increased by insurers, they should justify increases based on their experience in any given state and based on that state's body of law and other relevant factors, such as its tort litigation climate. Otherwise, legislatures which pass measures, such as tort reform, cannot be assured that the reform will result in more affordable rates for their own citizens.

New Jersey's Assembly Insurance Committee, armed with subpoena powers, is about to undertake a review of insurers' underwriting practices as well as their ratemaking procedures for commercial risks. Among other things, the Committee hopes to determine whether insurers should be required by statute to maintain better statistical data. Without this kind of comprehensive data, state legislators cannot make informed public policy decisions to address the liability insurance crisis.

Other suggestions for regulatory initiatives include establishing market assistance plans to help in securing coverage, utilizing of "claims made" rather than "occurrence based" policies, enhancing regulation of surplus line carriers, lowering the premium-to-surplus ratios required for specific lines of coverage, prohibiting cancellations and nonrenewals, and limiting the types of policy exclusions which can be added by insurers on renewal policies.

Of the large number of bills before the 43 legislatures in session, a significant number of them deal with some aspect of tort reform. These include placing caps on liability, establishing pretrial screening panels to eliminate frivolous suits, abolishing or modifying the doctrine of joint and several liability, authorizing structured settlements and reinstituting some form of sovereign immunity.

Another suggestion is to establish a statewide excess fund for municipalities and to establish statewide pools for professionals or businesses. West Virginia is presently considering establishing such a fund and similar legislation has also been introduced in New Jersey. Obviously, a proposal such as this needs to be carefully constructed. Ample provision must be made for loss reserves. It may, however, be an important alternative in cases in which commercial insurance is simply no longer available for excess limits coverage.

I think that it may also be in order to make some provision in state law for providing technical and other assistance to municipalities in dealing with their insurance problems. Some of the larger public entities have very sophisticated risk management systems while smaller units of government may not have the wherewithal to secure the best coverage available at the best price. At least four states, including Missouri, Oregon, Pennsylvania, and South Carolina, have already established some type of centralized risk management program.

As you are well aware, the regulation of the insurance industry has traditionally been the province of the states. I believe that the states have discharged their regulatory authority in this area in a responsible manner. I see no compelling reason to supersede the states' authority in this area with a federal regulatory scheme. For one thing, insurance contracts issued in any given state must by necessity, conform to the basic provision of state law. Laws which differ must, of necessity, result in insurance contracts which differ. And, this, in turn, results in differing rate structures. Consequently, in my view, the optimum level of regulatory efficiency must rest at the state level.

While I do believe that this present crisis is a serious one, NCSL believes that the states are capable of resolving present problems. Federal intervention from NCSL's perspective, would be premature at this point. This is not a dismissal of future need for federal action should states prove unable to completely resolve all aspects of availability and affordability problems.

One area in which federal involvement might be beneficial is that of examining the financial condition of insurers. Although it is a critical state function, it is possible that states do not have all the necessary resources to examine and monitor the very large insurers who operate on a multistate basis. It might be that some type of federal examining agency would be useful to assist states in ensuring the safety and soundness of insurance companies and in cooperating with foreign governments whose domestic insurance companies insure risks in the United States.

I also think, speaking for myself, that the federal government may well have a role to play in the regulation of reinsurance companies. It is clear that severe disruptions in the reinsurance market have contributed significantly to present problems. It has been alleged that these problems have been caused by new entrants in the field of reinsurance who were undercapitalized and failed to follow conventional business practices of the industry. There seems to be little doubt that these companies need to be more stringently regulated. Because of their multi-state and even multi-national nature, they have largely escaped state regulation. I think that this is a matter which needs to be addressed promptly.

Both of these aforementioned areas as well as other issues are likely to be continuously examined by NCSL's State-Federal Assembly.

I can assure you that the NCSL will cooperate with you in every way in your deliberations on this issue, and I want to thank you again for affording me this opportunity to participate in these hearings.

SUMMARY—SELECTED STATE LEGISLATIVE ACTION

The attached summary represents various actions taken, under consideration or planned for the interim by state legislatures. This list highlights legislative activity and some regulatory initiatives. It is not a comprehensive survey of all pending legislation or of future introductions. There are no assurances that legislation indicated as passing both houses will be signed by the governor.

In most instances the information was developed through telephone discussions with legislative research and legal staff in the states.

HAWAII

Under consideration

establishing medical malpractice reforms.

relieving state and local governments of liability insurance unavailability problems.

abolishing joint and several liability.

KANSAS

Under consideration in 1986

cap medical malpractice awards at $1 million per defendant.

cap awards against various licensed professionals.

adopt comparative negligence.

prohibit nonrenewals and cancellations unless certain criteria are met.

Previous action

eliminated joint and several liability for public entities.

established a voluntary market assistance plan.

Study groups

Joint House and Senate Insurance Committees.

Insurance Commissioner's Task Force on Liability Insurance.

KENTUCKY

Under consideration

limiting awards.

expanding municipal government's sovereign immunity.

Previous actions

created a Board of Claims to handle suits brought against the state.

LOUISIANA

Previous actions

In 1985, defined actions for which individuals and entities could be sued as part of a comprehensive tort reform effort.

convene session in April.

MISSOURI

1986 Action

enacted SB 663 capping medical malpractice awards at $335,000 per defendant. Governor has signed the bill.

NEBRASKA

Under consideration

capping medical malpractice awards.

limiting liability of local governments.

NEW MEXICO.—1986 SESSION COMPLETED

expanded the state's risk management program to include provision of property/casualty liability coverage.

rejected limits on attorneys' fees.

Study groups

establishing a legislative liability insurance study committee.

NORTH CAROLINA.—1986 SPECIAL SESSION COMPLETED

authorized, on a standby basis, the Insurance Commissioner to establish joint underwriting associations.

authorized the Insurance Commissioner to extend the state's FAIR plan to all areas of the state.

called for a referendum on a state radioactive repository site act.

SOUTH CAROLINA

Under consideration

expanding Tort Claims Act of 1985 to municipal governments.

medical malpractice remedies.

Previous actions

modified collateral source doctrine.

reduced attorneys fees.

capped non-economic damages.

SOUTH DAKOTA

Under consideration

establish a self-insurance pool for public entities.

modify the collateral source rule.

place absolute caps on general and special medical malpractice damage judgments.

modify joint and several liability.

limit punitive damages to $25,000.

limit attorney contingency fees.

expand insurance company reporting requirements to include premiums paid, claims filed, reserves on hold and investment income.

establish a market assistance plan.

TENNESSEE

Under consideration

dram shop liability reform.

expanding insurance industry regulation generally and strengthening rate regulation specifically.

Previous actions

Established a Claims Commission to handle suits against the state.

UTAH.—1986 SESSION COMPLETED

repealed joint and several liability.

authorized establishment of market assistance plans and joint underwriting associations.

limited directors' and officers' liability through revamped standards of care.

rejected modifications to statutes of limitation, mandatory arbitration and establishment of pretrial screening panels.

VIRGINIA

no action expected in 1986 session.

will establish an interim study committee on the entire liability insurance issue

WEST VIRGINIA

Under consideration

establishing a self-insurance fund.

strengthening insurance industry regulation.

limiting awards.

limiting attorneys' fees.

capping medical malpractice awards.

WISCONSIN

Under consideration

extend Insurance Commissioner's authority for establishing risk-sharing pools to commercial liability coverage.

establishing an industry funded hotline for businesses unable to get coverage.

cap medical malpractice awards at $3.3 million.

require insurance companies to provide statements verifying premiums paid, losses incurred and reserves for product liability coverage.

Study groups

legislative study subcommittees on Industry Conduct and Tort Reform.

Insurance Commissioner's Task Force.

WYOMING

Under consideration

limit joint and several liability.

limit awards to $500,000 per defendant.

establish a state self-insurance fund.

permit pretrial screening.

expand information which insurance companies must file and broaden qualifications for licensure.

reinstitute sovereign immunity.

WASHINGTON

Under consideration

alter method of funding the Insurance Commissioner's Office from general funds to fee-based revolving funds.

authorize establishment of joint underwriting associations for all liability insurance lines or for day care only.

use Washington State and regional data regarding claims history, premiums paid, etc.

cap damages ($250,000 for general damages) or utilize a formula for various types of damages.

modify joint and several liability based on proportion of plaintiff negligence.

structured settlements.

the House has passed a resolution calling for modification of the McCarran-Ferguson Act.

cap on annual premium increases.

Previous actions

placed prohibitions on nonrenewals and midterm cancellations without prior notice.

The CHAIRMAN. Thank you, Mr. Speaker. Mr. Motley.

Mr. MOTLEY. Thank you, Mr. Chairman.

I am John Motley, the director of Federal legislation for NFIB, the National Federation of Independent Business. I would like to commend you and the members of the committee for holding this very needed hearing today, and to thank you for the opportunity to testify on behalf of NFIB and its more than 550,000 members coast to coast.

Rather than add to the list of examples and horror stories that you have had spread before you today, let me share with you for just a moment, if I can, the reaction of the American small business community to the crisis in the availability and cost of insurance.

The first thing to note is it tends to spread across all lines of small business. We get a constant drumbeat of complaints from NFIB members in all of the various different industries that you have heard from here today, and others which are not even represented.

At a forum last year in Los Angeles held by the vice president and NFIB supposedly to discuss tax reform, the liability crisis turned out to be the No. 1 problem and the only thing that anybody wanted to discuss—above tax reform, and above the budget deficit. And that is quite a statement coming from fiscally conservative small business people.

In a series of town meetings held last month by NFIB's president, John Sloan, with a number of State insurance commissioners, the reaction f the community was extremely negative and hostile, so much so in several of the meetings the commissioners that came to represent the States had to leave before the meeting was finished.

In the 40 White House Conference meetings that have been held across the country so far, comprehensive civil justice reform, doing something about the liability crisis in insurance has been either the No. 1 or the No. 2 recommendation from all of those meetings.

NFIB has just finished surveying its members on its most important problems, and that study is not published yet but it will be published in the next week or so. And the crisis in liability insurance comes out second of the 75 areas that the membership were quizzed on. It was rated the most critical by 38 percent of those members who responded, and that is the highest percentage rating an issue as the most critical.

We view the causes of the crisis to be multifaceted. First of all, it appears to us that the tort system, the civil justice system of the country, is out of control. The expansion of liability, the definition of liability, huge awards which are coming down, and increase in litigation which is being filed are areas that need to be addressed.

We also though believe that you have to take a look at other areas other than just the civil justice system. We believe that the insurance industry must bear some of the blame for its business practices that brought on the crisis in the late 1970's and early

1980's, and we also are somewhat confused and amazed by this patchwork quilt of haphazard State regulation of this industry, which tends to give it an upper hand in dealing with State insurance regulatory bodies on an individual basis.

As far as solutions are concerned, NFIB members support comprehensive reform of the civil justice system and a national tort law. In just February in our mandate poll of all 550,000 members, 84 percent of the members responding voted in favor of a comprehensive reform of the system.

As far as products liability tort law is concerned, we have polled the issue three times over the last 5 years. In the two previous times, the membership has voted against a national law, being very much for action at the State level instead. In December 1981, only 37 percent of the membership favored a national law; in July 1982, that had risen to 45 percent; and in the most recently completed poll, December 1985, 65 percent, or almost two-thirds of the members responding, now favor some sort of a national product liability tort reform law.

In addition, Mr. Chairman, I would like to submit for the record a compilation of votes taken by NFIB members at the State level on various different solutions as far as civil justice and tort reform are concerned.

We also believe that in addition to taking a look at the civil justice system and at tort law, that there is a need for this committee and for the Congress to review those laws which govern the operation of the insurance industry. We believe it is time to take a look at whether the McCarren-Ferguson Act is still justified; whether the FTC should be prevented from reviewing and regulating the insurance industry; and whether or not we might need minimum Federal standards for State regulation of the industry itself.

We do not have official positions on many of these issues yet. We are still in the process of polling our membership, and I believe that you know that NFIB does not take positions on issues like this until we go to the membership and ask them. But right now we are currently polling all of our members on five issues which are important to this crisis, and also important to the product liability issue that you are dealing with in the committee.

Those five issues are the capping of legal awards, no-fault victims' compensation, expedited claims procedures, minimum Federal standards for the insurance industry, and a Federal reinsurance program.

I would be happy to answer any questions that the committee might have, Mr. Chairman, or to submit any additional material for the record.

[The statement follows:]

STATEMENT OF JOHN J. MOTLEY III, NATIONAL FEDERATION OF INDEPENDENT BUSINESS

The National Federation of Independent Business (NFIB) represents over 500,000 small and independent businesses nationwide in all sectors of commerce. On a scale with their response to the divestiture of AT&T, NFIB members have universally expressed confusion and apprehension over another service component of business operations: commercial liability insurance.

For the past six months we have been contacted regularly by members complaining about insurance unaffordability and, in some cases, unavailability:

A laundromat owner in Corpus Christi was sued because a lady was mugged in one of his laundromats. He refused to pay, but his insurance company settled with the lady out of court. Last year he paid $900 for $2 million in coverage. This year he is paying $3,625 for $1 million in coverage.

A small chemical company (14 employees) in Gulfport, Mississippi paid $4500 for $300,000 coverage. This year they have been quoted a premium of $38,000 for $500,000 coverage.

A campground in Hagerstown, Maryland last year was charged less than $1000 for $1 million in coverage. This year the same coverage costs $8000.

A plumbing and heating contractor in Warren, New Jersey received notice that his policy had been cancelled without explanation.

An aircraft corporation in Waco, Texas paid $25,000 in 1983, $50,000 in 1984, and $200,000 in 1985 for $2 million in coverage.

A five-and-dime store in New Lexington, Ohio has seen premiums increase 20% between 1984–1985 and 50% between 1985–1986.

A manufacturer of food processing machinery in Marblehead, Ohio paid $50,000 with a $2500 deductible in 1985. This year the premium is $150,000 with a $50,000 deductible. This year's policy would also require the manufacturer to pay legal expenses for settling claims and to provide a letter of credit to the insurer in the amount of $300,000.

An elevator repair and maintenance company on Staten Island paid $3500 for $5 million coverage in 1984. In January 1985 the policy cost $17,500. In July 1985 the policy was cancelled. Another carrier has offered coverage for $72,000 in annual premiums.

An auto parts and towing company in Walton, Ohio is being charged $20,000 this year for coverage which cost $11,000 last year.

An insurance agent in Boundbrook, New Jersey received notice from two companies that they were no longer accepting any applications for commercial liability insurance. Also, these companies were reviewing all renewals for possible termination.

In addition to hearing directly from our own members, we have heard from hundreds of small businesses at the White House Conferences on Small Business. These conferences are being held in every state prior to the national conference, which will be held in Washington in August. At these conferences, small business owners vote on recommendations for federal action on small business issues. The top new issue coming out of these conferences is insurance. With over half of the conferences completed, insurance has emerged as the foremost concern aside from the budget and taxes.

Small business is in a Catch-22 situation when it comes to liability. Legal counsel at certain times and insurance all of the time are necessities. However, legal counsel is expensive; in-house counsel is out of the question. With regard to liability coverage, self-insurance, and in most cases group insurance, are not options for small business. Currently, obtaining certain lines of coverage on the open market may be virtually impossible.

We know that all type and sizes of businesses are experiencing a major problem with almost all commercial lines of insurance. We believe that the solution must be comprehensive enough to address what we see as the multiple causes of the problem.

THE CAUSES

There is, as you know, disagreement on the circumstances which led to the current crisis. The main dispute is between the insurance industry and the trial lawyers. The insurance industry lays most of the blame for the situation on the attorneys and the civil justice system. They claim that excessive litigation, overly generous court awards, and greedy attorneys have strained insurance reserves and thus raised the costs of underwriting. While admitting that they underpriced insurance to gain investment capital when interest rates were high, they maintain that tort reform is the answer to the problem.

The attorneys accuse the insurance companies disclaiming the notion that Americans have become more litigious and that attorneys do little to discourage frivolous lawsuits. They contend that most of the problems are due to poor management of investments made by the insurance companies, and they point to the companies' strong performance in the stock market as evidence of the healthy financial status of the industry as a whole.

One other group must be mentioned. The insurance commissioners have done little fingerpointing except at erroneous predictions regarding interest rates, upon which they made many decisions. Although they must operate within statutory limits, they all have authority to review rates either before or after implementation. However, like state tort law, the theory and practice of insurance regulation varies from state to state.

We see some truth to all sides' arguments, and we propose consideration of several areas of reform. Before I elaborate, let me emphasize that we are still gauging membership opinion on most of these proposals.

THE SOLUTIONS: TORT REFORM

As you may know, NFIB is a charter member of the American Tort Reform Association (ATRA), a new coalition of business groups in favor of tort reform. NFIB membership supports tort reform at both the state and federal levels. In response to the question, "Do you favor or oppose comprehensive reform of the legal system to reduce litigation and limit the liability of defendants in civil suits?", our members voted 84% in favor, 5% opposed, 11% undecided. In twenty-four states, NFIB state directors have polled member opinions on various reforms of state tort law, and those results have likewise indicated their support. We support the following reforms, which many of the state legislatures are already considering:

1. Cap awards for noneconomic damages.
2. Limit contingency fees.
3. Implement alternative dispute resolution (ADR) mechanisms.
4. Penalize parties that engage in frivolous litigation.
5. Modify pure comparative negligence standards.
6. Abolish joint and several liability.
7. Require judges/juries to itemize elements of awards.
8. Require judges/juries to consider collateral sources of compensation in determining awards.
9. Eliminate "ad damnus" causes.
10. Allow payments of awards in installments.

SOLUTIONS: INDUSTRY REFORM

A major concern of ours is the exercise of discretion by insurance companies in cancelling or not renewing policies. Notification periods are often short, and little if any explanation is given to the policyholder. Claims history seems to have no bearing on an insurer's decision to cancel or not renew. Industrywide cancellations leave insurance agents hard pressed to obtain coverage for clients, and small business owners have neither the time nor the expertise to seek out coverage for themselves.

At the state level, some insurance commissions have enacted temporary initiatives, such as moratoria on mid-term cancellations. Legislation is being considered in some states to require adequate notification periods and/or just cause for cancellations and nonrenewals. We support these actions as well as the formation of assigned risk pools and Market Assistance Programs (MAPs).

Another concern is the expanded use of claims-made policies for basic, commercial liability coverage. Claims-made policies are the insurance industry's immediate answer to the problem of unavailability because this type of coverage reduces the financial exposure of the insurance companies. According to industry representatives, claims-made policies are less expensive than occurrence polices. However, the cost of retroactive coverage to insure against liability incurred prior to the effective date of a claims-made policy, known as a "tail," will most likely neutralize, if not outweigh, any savings accrued through the initial purchase of a claims-made policy.

Claims-made policies have already been approved by most state insurance commissions and are being written by many companies. We urge strict monitoring of the implementation of these policies. Such oversight should be undertaken at the state level and possibly at the federal level as well. At the very least, insurance agents should be required to indicate clearly to policyholders the differences between the conventional occurrence policy and claims-made.

SOLUTIONS: REGULATORY REFORM

The existing regulatory system does not work. In contrast to the regulation of utilities, regulation of the insurance industry has not maintained available and affordable service, nor has it preserved the financial health of insurance companies. Insurance commissioners are charged with the responsibility of ensuring that rates are not "inadequate," "excessive," or "unfairly discriminatory," but the industry itself admits that policies were underpriced in the late 70's and early 80's. Many would contend that current premiums are excessive. Perhaps part of the problem is understaffing of commissioners' offices, which might be solved by earmarking more of the revenue collected in state premium taxes for this purpose.

The real problem, though, may be the political feasibility of a commissioner executing the powers of office. Consumers like low rates, and commissioners because they are either elected or appointed, like to please consumers. Without protection from public pressure, they may not be able to make unpopular decisions. One way to diffuse the political heat would be to create multi-member insurance commissions similar to the structure of most public utility commissions.

Another approach would be to establish statutory minimum standards pertaining to the financial condition of insurance companies. Such standards might be derived from the leverage and exposure ratios currently developed on an advisory basis by the National Association of Insurance Commissioners (NAIC) for use by insurance companies and commissioners.

We do not at this time have a recommendation on whether industry and regulatory reforms should be undertaken at the federal level. However, we urge Congress to consider the reforms mentioned and to examine two other potential areas of concern. The McCarran-Ferguson Act has long been a source of controversy, but whether or not modification or repeal would improve the availability and affordability of insurance is uncertain. The other area of concern is reinsurance. The alleged influence of reinsurers over insurers has been publicized, as has the presence of foreign reinsurers in the American market. More information in needed in this regard.

Thank you for the opportunity to participate in this hearing. We look forward to working with you, Mr. Chairman and members of the committee, as you continue your consideration of insurance availability and affordability.

The CHAIRMAN. Thank you, sir. Mr. Hemphill.

Mr. HEMPHILL. Thank you, Mr. Chairman.

I am here today in a dual capacity, both as the official representative of the county of Platte County, MO—that was a unanimous vote by a bipartisan county commission, and when it comes to county liability a somewhat panic-stricken county commission.

I am also here as a participant in the National Association of Counties' Task Force on County Liability and Insurability. I carry with me a letter from the chairman who recognizes my testimony and asks to enhance it further.

If I may just briefly describe to you the situation in Platte County, MO, and then I will discuss in more detail the Federal legislation which we feel would be helpful. In 1984, Platte County joined with 26 other Kansas City area municipal and county governments to form the Mid-America Regional Council Insurance Trust. This effort at self-insurance was thought to be a great benefit for all of its members, and it was for the very first year. My county's total premiums during 1985 were $44,000.

That $44,000 got us a $1,000 deductible on public officials' errors and omissions, and a total umbrella coverage of nearly $5 million. This year our premiums, 1 year later, will total $115,000 with a $10,000 deductible, and total umbrella coverage of only $2 million. And that is after our own self-insurance effort.

In the areas of general auto and crime liability, our insurance trust has been unable to find any company to reinsure us. Therefore, we have an aggregate coverage for all 27 governmental entities of $1.7 million. For the right to compete with our sister cities and counties for a one-time cap of $800,000, we pay $58,000 a year.

We are fully aware that one of the best methods of cutting down our costs in coverage and vulnerability to suit is to implement risk management, and we are doing that. I realize that this committee's hearings are dealing with liability insurance problems of both public and private sectors. However, it is the county whose business lends itself so aptly to being sued where we find ourselves so vulnerable.

The ever-increasing exposure of counties to crippling judgements the concurrent inability to insure against this increased liability presents a crisis problem which I believe is attributable to the convergence of four different and separate financial legal problems:

First, poor management by the insurance industry over the last decade has resulted in a substantial lack of capacity to write affordable insurance. This has placed considerable pressure on perceived high-risk customers.

Second, federal laws have been interpreted so broadly within the last 25 years that litigation is highly encouraged in areas of commercial or property rights violations instead of possible governmental violation of human rights.

Third, State laws reducing sovereign immunity.

Fourth, Federal and State procedural changes have encouraged suits with the lure of attorneys fees.

There are currently bills pending before the Missouri General Assembly which begin to relieve some of the pressure upon our county. The most notable is a bill to create a State-operated and State-funded reinsurance pool for county and local governments. This would create a system of reinsurance not too dissimilar in concept from the already existent workmen's compensation. I am not at all optimistic about its passage, and I truly do think that such a State law would be much more akin to placing a Band-Aid on a national hemorrhage.

The expensive explosion of county liability is a result of Federal law. Although counties are potential defendants in lawsuits brought under many Federal pieces of legislation, the majority of such litigation is brought under section 1983 of section 42 of the United States Code. That statute was originally passed in 1871 to implement the Civil War amendments, and was aptly named section 1 of the Ku Klux Klan Act.

For nearly 100 years this act was used to redress wrongs generally considered human rights violations. In 1960, in fact, only 270 cases were filed under section 1983 in all Federal courts in the entire Nation. In 1961, section 1983 clearly made liable those individual states and local officials who carry a badge of authority and misuse it. Seventeen years later in the *Monelle* case, the Supreme Court expanded this concept to make local governments themselves directly liable for such actions where the Government's policy or custom inflicts injury.

Within 6 years of the *Monelle* case, the explosion in section 1983 was obvious. By 1984, a single generation later, over 38,000 section 1983 cases were filed in the Federal court system. Counties and other agencies expend nearly $1 billion each year for the defense of these actions, not including the judgments and the settlements.

Perhaps the greatest threat of this statute is currently in the making in a case pending before the Supreme Court. The Supreme Court will decide in *McDonald* v. *Yellow County* whether or not a local land use decision can also be redressed under section 1983. In a position reversal of historic proportions, the current administration's Justice Department has decided to side with the developer whose subdivision platt was rejected, and ask the Court to remand the case to a lower court for determination of damages under section 1983.

I strongly urge this committee to favorably consider legislation which would return the original intent of the Ku Klux Klan Act of 1871, and thus stem the tide of bankrupting local governments. Senate bill 436 as introduced by Mr. Hatch and Mr. Thurmond may very well be the proper antidote.

The only other area of Federal legislation which I wish to discuss is those areas that invite suits. This invitation to suit is paralleled by the philosophy in many attorneys' fees statutes. Attorneys fees are often disproportionate to the results obtained. In a noted Michigan antitrust case, the plaintiff was awarded $3,500 and attorneys' fees of over $400,000. A Virginia city was ordered to pay $37,000 in attorneys' fees to a plaintiff who only won $1,500.

Closer to home in Kansas City, a desegregation lawsuit has been dragging on for nearly 7 years. While I do not question the nobility of the attorney who sued on behalf of the plaintiff and the inconvenience it has caused his private practice, I do question the size of his request for attorney's fees. His request was for nearly $3.5 million, and when supplemented by another request by the NAACP legal defense fund, the total request is nearly $7 million in attorneys' fees.

Prior to my county's joining the insurance trust, we were covered by a private insurance carrier which, as of last December, has declared bankruptcy. There are currently still pending two lawsuits with claims exceeding $100 million. The taxpayers may very well be burdened with the attorneys' fees in any amount in excess of the defunct insurance company's deposit with the State.

This is not a problem of shifting money from one budget to another. It is not a problem of funny money simply added into the deficit. We are required to balance our budget on the local level. This is a problem which, when ignored at the Federal level, places a very significant tax burden on the local taxpayer who still must pay for the services of local government.

I strongly urge the favorable consideration of S. 1580, the Legal Fees Equity Act.

Thank you, Mr. Chairman.

The Chairman. Thank you very much.

Let me say that I, came here from the Missouri attorney general's office, where we were spending an increasing amount of our time defending those cases. This was as of 1976 when I left that office. It was the biggest waste of time I have ever been involved with in my life.

Mr. Hemphill. I agree wholeheartedly, Mr. Chairman. Even in a county of ~~my~~ size, we are contemplating having to add another full-time county counselor just for those lawsuits.

The Chairman. As I recall, one inmate of the State penitentiary filed a lawsuit on the basis that a guard at the penitentiary had taken a package of cigarettes from him. We had to have at least one lawyer working on that for weeks. The reason we had to do it is we felt we could not afford to lose any of those cases. But unfortunately section 1983 is not within the jurisdiction of this committee. I wish it were, but the Parliamentarian tells us it is not. So we have not been able to deal with that one.

Let me ask, Dr. Todd mentioned this with respect to the defensive practice of physicians, but is it generally true that people act differently when they fear lawsuits are going to be filed—and not necessarily positively? The point is made that one of the effects of personal injury law is that it does provide mighty incentives for safety. We had thought that—some people had thought that the need for Government regulation was minimized by the fact that people would do their own regulating, or their insurance companies would do the regulating for them by insisting that safety measures be taken as a price for relatively low premiums.

But have we tipped over now to the point where liability for injury is no longer an incentive to do something socially beneficial—namely, be safe—but it has gone beyond that to do something that maybe is not so beneficial—namely, engage in great defensive tactics which at best are wheel spinning and at worst are extraordinarily expensive and violative of basic common sense?

Dr. TODD. Senator, I think you are absolutely correct in that analysis. No physician sets out to perform malpractice. The peer review system within the profession has worked hard and, despite an extensive risk management program put together by doctor-owned companies, most of the benefit has come from helping physicians understand the legal ramifications and not necessarily improving the quality of the practice.

On the other hand, we have some very good studies to show that the physicians who have been sued—and you have heard the figures, most of them are going to be eventually—are never quite the same again. They see patients as adversaries. Their confidence in their professional activity is shaken. They have a higher incidence of suicide, a higher incidence of substance abuse, a higher instance of divorce, and tend to move from community to community.

Of those few physicians who have not as yet been sued, they live in absolute constant fear that tomorrow is the day the subpoena is going to arrive. Recent studies published in the New England Journal of Medicine suggest that even in medical school the legal considerations of professional decisions are appearing increasingly frequently in medical school lectures, and in many instances have nothing to do with the quality of care.

The CHAIRMAN. How about the rest of you? Do you think that we have now become so litigious that tort liability is something worse than it used to be? If it was once a safety measure, has it become something other than that now?

Mr. MOTLEY. Mr. Chairman, we receive many letters every year from members indicating that there are possibly new products they want to bring into the marketplace, or changes they wish to make in current products that they simply will not consider doing because the liability of doing it is too great. In addition, simply within NFIB some of the decisions that we have made in the last year, whether to provide certain types of information to the membership even on how they can comply with hazardous waste laws, whether that makes NFIB liable eventually for the interpretation of that information, are things that we discuss almost on a monthly basis internally.

The CHAIRMAN. Do you think we are less competitive in, for example, foreign trade because of the cost of insurance and because of the defensiveness of American business?

Mr. MOTLEY. I do not consider myself to know enough about that to give you an accurate answer, but I can certainly——

The CHAIRMAN. A lot of people have said that for every lawyer in Japan we have a multiple of some sort. They go on to say we should export lawyers.

Mr. MOTLEY. I know some lawyers who would like to export lawyers to reduce the competition, but there certainly are people who hold that view strongly—not to export lawyers, but the fact that it puts us at a disadvantage in the international marketplace, and that might be an avenue for the committee to look at.

The CHAIRMAN. Well, there is no doubt. Your members indicated this when they met with the Vice President. He wanted to talk about tax reform, or the budget, or something else, and they wanted to talk about the tort problem. There is no doubt that it is a major, major concern to business, is it not?

Mr. MOTLEY. You cannot get a group of business owners together in a room without talking about tort problems now. It is impossible.

The CHAIRMAN. We were intending to have a hearing in this room some months ago on the question of truck deregulation, and the trucking firms who came in wanted to talk about their insurance problems.

Do any of you have any thoughts about the wisdom of legislating caps for recovery? That is, our general assembly has done that with respect to medical malpractice. Is that not right?

Mr. HEMPHILL. That is correct.

The CHAIRMAN. Is that a good thing to do? I suppose somebody, either here or at the state level, could pass legislation that said, well, if you lose a hand it is worth *x* dollars; and if you happen to be a concert pianist you can insure your own hand. But is that sort of a capping of recovery a good idea, or is that a bad idea?

Dr. TODD. Senator, I think it depends on the method by which it is done. Certainly the medical profession has been out front in asking for caps on awards, but on noneconomic awards. I think someone who is injured as a result of negligence is entitled to receive whatever it takes to rehabilitate, maintain, or in some fashion make sure that they survive in this world with whatever handicap they have acquired.

On the other hand, the use of pain and suffering as either a transfer of wealth, a measure of punishment, deterrence, call it whatever you want, is in the eyes of the jury or in the eyes of the beholder. It is not measurable. That is where the greatest amount of dollars could be saved without jeopardizing the rights of an injured party to fair compensation.

We have evidence to show in medical malpractice cases, for example, that in awards over $100,000, 80 percent of those dollars then represent pain and suffering awards and not economic loss.

The CHAIRMAN. Well, I want to thank all of you for being here, for your patience in waiting so long. I am not going to drag this out any longer, because you might die of starvation before my very eyes. But I do want to thank you.

I want to announce that the record is going to be kept open for answers to questions for another 2 weeks.

[Whereupon, at 1:43 p.m., the committee was adjourned, subject to the call of the Chair.]

ADDITIONAL ARTICLES, LETTERS, AND STATEMENTS

STATEMENT OF THE AMERICAN BUS ASSOCIATION

We appreciate the opportunity to provide an update to you about the continuing insurance problems that confront the intercity bus industry. American Bus Association president Norman R. Sherlock testified twice to this committee on the insurance crisis: on October 21, 1985, before the Surface Transportation Subcommittee; and, on December 3, 1985, before the Subcommittee on Business, Trade and Tourism. This submission will update what has happened since Mr. Sherlock last testified.

The American Bus Association represents more than 3,500 companies involved with bus regular route, tour and charter, airport and commuter services, and businesses which are related to travel and tourism.

Today, the bus industry is facing a crisis caused by the unavailability of reasonably priced insurance. As we will describe here, this problem has been and continues to compound itself as time goes by. This is the industry's major problem this year, it was last year, and it will continue to be for the foreseeable future.

In his earlier testimony, Mr. Sherlock referenced several case examples and drew conclusions pointing to an average insurance premium per bus of about $6,000 and some quotations as high as the $12,00–$15,000 range. We can amend that statement at this time. The best premium quotations today are never under $8,000 per bus and quotations have been received in excess of $20,000 per vehicle. Members of the American Bus Association are absorbing these costs—costs of providing transportation services in a legal manner.

The posture of ABA members is considerably worsened by a lack of effective regulatory procedures. Bus operators who choose not to purchase the required minimum level of insurance can operate, in our opinion, virtually unchecked. Most carriers in our industry conscientiously meet minimum insurance standards and more, but there exists a minority who do not. These carriers pose serious problems to the public through inadequate coverage and to the legitimate industry because their lack of insurance gives them a substantial cost advantage over carriers operating legally. It is the responsibility of the Interstate Commerce Commission to force these companies to cease operations, but we believe that the ICC's enforcement effort in this regard is inadequate. This lack of adequate enforcement will ultimately lead to serious consequences and we urge careful attention by Congress to this area.

The ABA has responded to the insurance crisis in several ways. As a continuing result of our efforts, we have noted several changes and trends over the past several months worthy of discussion here.

The two problems immediately of concern are cost and availability. We have seen changes in each. Many industry groups and government entities have held meetings and symposia to share information and to try to come up with solutions to the liability insurance crisis. At ABA's suggestion, members of the Travel and Tourism Government Affairs Council met in January to review the problem and to see what legislative action could be taken on both the federal and state levels. Council members discussed such things as the importance of industry unity, meeting with elements of the insurance industry and others who may be seeking reasonable tort reform, and trying to determine appropriate prototype legislation on such issues as tort reform and risk retention. A number of coalitions concerned specifically with the question of tort reform have emerged and more are in the offing. We have joined the American Tort Reform Association which is headed by former Congressman Jim Coyne (now Executive Vice President of the American Consulting Engineers Council).

While industry coalitions seek solutions, the availability and price problems affecting us continue unabated. In December, the Transit Casualty Company, a long time insuror of buses was declared bankrupt. It was the apparent victim of a series of problems, both internal and external, which even the enormous premium increases of recent months could not solve. The loss to the bus industry of its one-time largest insuror carries with it a heightening of availability problems for the entire industry, as well as a multitude of problems to insureds of Transit from immediate cancellations to future claims liability.

While debate rages over insurance company profits and losses, liability insurance costs continue to rise. Articles in the Washington Post reviewed the details of a debate between the insurance industry and both Ralph Nader and the National Insurance Consumer Organization. While we make no judgments on the validity of any argument over profits or losses, it is apparent that both insurance companies and we are being victimized by inappropriate jury awards to injured parties and the broadened concepts of liability accepted by the judicial system.

The worst of all worlds appears, however, in the pricing of liability insurance coverage for individual buses. Insurance prices for various fleets in various locations with differing loss histories are remarkably the same. We hear from bus operators all across the United States. They supply us data on fleet size and quoted prices for specific coverages. One insurance company writing bus insurance today, apparently quotes $11,000 per vehicle to virtually every request. this type of pricing of potential risks means that no true underwriting is being done. Insurance underwriters historically consider location, geographic operational area, loss or claim history, management attitudes, financial soundness, and operational practices. With this number of variables, sound underwriting procedures would seldom produce a duplicate quotation. Today, duplicate quotations seem to be the rule.

The worst effect of this practice is the dis-incentive for safety it produces. If two bus companies pay the same—regardless of how hard one tries to reduce accidents and how little the other may do in the same area—it is easy to see that safety costs, it does not save.

The American Bus Association has sought to alleviate such practices by initiating communication with the American Insurance Association. We have begun to provide them with bus industry data that they indicated at earlier hearings they did not have. We are attempting to see what can be done mutually to try to resolve this problem.

In late September, ABA sent a letter to all governors urging them to: freeze the premiums and policies of insurance companies doing business in their states; examine alternatives to private insurance that the state could provide through assigned risk pools with reasonable rates and readily available coverage; and, review the enforcement mechanism for dealing with companies operating with inadequate or no coverage and take them off the highways. Further, we suggested that each governor follow the lead of Governor Tom Kean of New Jersey who issued an emergency order prohibiting insurance companies in that state from cancelling, refusing to renew, or increasing premiums in place until the state insurance department adopts new regulations to meet the unexpected situation at hand.

To date, some 34 governors have responded to our letter. In general, they are concerned and will look into the situation and try to find a solution. Various actions are being taken while others are being investigated. There is surely genuine interest in solving the problem—but no panacea has emerged.

At the federal level, there have been several separate attempts to alleviate the crisis, or mitigate its results.

Rep Glenn Anderson, Chairman of the House Surface Transportation Subcommittee, has requested a report from the Interstate Commerce Commission on the effects of the insurance crisis. This request centers upon the availability/cost problems facing the bus industry. Further, specific details of compliance levels are requested. We believe the ICC will be unable to provide meaningful compliance data due to its lack of comprehensive enforcement ability.

Petitions filed by the American Trucking Associations and ABA requested the ICC to initiate an investigation into the insurance crisis. The petitions were granted and the ICC has begun its investigation. The Commission seeks to determine (1) the extent of the insurance crisis currently facing motor carriers of property and passengers, (2) the causes of the crisis, and (3) what, if anything, the Commission can do to alleviate the problem.

ABA filed comments with the Commission in which we asked for a rulemaking on the petition we had filed earlier that carriers be required to file with the ICC the amount of insurance they currently carry. Further, we asked that the ICC enforce the required minimum levels of insurance that were effective November 19, 1985.

Additionally, the ABA requested that the Department of Transportation (Bureau of Motor Carrier Safety) initiate a rulemaking requiring on-board proof of insurance in order to operate in interstate commerce. This petition is still under consideration.

As the insurance crisis continues, the effect on the intercity bus industry continues to grow. The effects are these:

1. A reduction in fleet size by many operators. The sale of vehicles, despite business levels justifying larger fleets, is conducted either to reduce the number of vehicles requiring insurance or to raise cash needed to pay insurance premiums.

2. The elimination of interstate operations by operators. By yielding their authority to operate on an interstate basis, these companies reduce their insurance levels to points at or above the generally lower domicile state requirements. Such a move lowers premium levels substantially and permits continued intrastate operations.

3. Cessation of operations, sale of the company or bankruptcy are each the documented result of high cost insurance.

4. Reduction or elimination of coverage. Many companies have eliminated collision insurance, placing investments of $100,000 or more at risk. Others have raised self-retention levels substantially, up to the total self-insurance application of Capital Motor Lines pending before the ICC.

The American Bus Association continues to react to the insurance crisis as well. As a service to the industry we represent, we have continued of offer our members—

1. A telephone hotline service—to respond to inquiries.
2. Periodic written updates—providing information and advice.
3. Development of insurance market alternatives.
4. Seminars, meetings and discussions helpful to companies in problem solving.

And, finally, after many months of work, we have an insurance program exclusively for ABA members. It is not, however, available in all states due to restrictions (generally of no-fault coverage), but we hope to reduce this list of locations now not served. Although far from a total solution, our new program is a step toward solving the problem, particularly that of availability.

We continue to advocate the positions we have taken in prior testimony before both House and Senate Committees. A solution is desperately sought and we once again make the following suggestions for consideration:

The Interstate Commerce Commission must ensure that all certified bus carriers are complying with the new insurance requirement ($5 million minimum) and shut down the operations of those that do not comply.

The Commission should put into effect immediately an expedited revocation procedure whereby a carrier's certificate would automatically be revoked 90 days after cancellation of its insurance.

The Department of Transportation must use its enforcement authority to force interstate bus carriers, particularly uncertificated carriers, to comply with the new insurance minimums.

Congress should adopt legislation making the insurance minimum clearly applicable to all commercial motor vehicles carrying passengers.

The Congress should examine bus industry insurance rates and propose action to force these rates to reflect the insureds loss experience.

Insurance companies should be required to give bus carriers conducting interstate operations a minimum of 90 days notice of policy cancellation.

Legislative remedies should be explored that would limit bus carriers liability in such a way as to bring insurance rates back down to a reasonable level for interstate bus carriers.

STATEMENT ON BEHALF OF THE SHIPPERS NATIONAL FREIGHT CLAIM COUNCIL, INC.

Comes now the Shippers National Freight Claims Council, Inc., hereinafter "The Council", by its Executive Director and General Counsel, William J. Augello, and files this statement on behalf of its members in the instant investigation.

I. THE COUNCIL'S INTEREST IN INSURANCE

The council is a non-profit membership corporation with over 750 members throughout the nation, consisting of shippers, receivers, carriers, insurers and intermediaries. The Council's objectives are to improve freight claim rules, regulations and practices and to prevent the in-transit loss, damage and delay of the nation's commerce.

The availability and cost of insurance coverage for the shippers, carriers and intermediaries and the liability exposure of such parties to a transportation arrangements, are of serious concern to the entire transportation community. The cost of insurance, as are all transportation costs, is ultimately borne by shippers paying the freight bill.

Therefore, the Council has a vital interest in this investigation and applauds the Commission's decision to seek solutions to the current crisis.

II. THE PROBLEM

The transportation industry has been singled-out by insurers as one of the categories of insurance requiring drastic revisions to help the insurance industry survive its current financial crisis. The financial crisis being experienced by insurers throughout the world has been attributed to:

a. The lowering of interest rates.
b. Depressed premium income due to uncontrolled rate-cutting.
c. High casualty losses in recent years.
d. Too much competition.
e. Bad investments by insurers.
f. Unsound underwriting practices.
g. Withdrawal of reinsurance from certain high-loss industries.
h. Exorbitant court and jury awards in U.S. Courts.
i. Congressionally mandated increases in minimum liability insurance limits for property and passenger carriers.
j. Increased concern for and restoration of the environment.

These events have resulted in serious changes in insurance coverage for shippers, carriers and intermediaries. For instance:

a. Insurers have cancelled carriers policies mid-term without regard to the carriers' loss records.
b. Premiums have been increased mid-term without regard to loss records.
c. Insurers have exited from the transportation market, despite their previous specialization in and collection of billions of dollars of premium revenue from the transportation industry.
d. Maximum coverage has been lowered, deductibles have been increased and coverage for certain types of casualties has been excluded in new policies.
e. Some reinsurers are withdrawing coverage and others are refusing coverage for certain primary insurers due to the primary's financial condition.

The end result is that many of our nation's carriers have been unable to obtain insurance and have been forced to discontinue operations. Others have been forced to pay exorbitant increases in insurance premiums. Unfortunately, many others are continuing to operate without insurance, in violation of federal and state laws, thereby creating a serious void in protection for shippers and the travelling public.

To illustrate the seriousness of this problem, one must consider the identity of the insurers that have withdrawn from the transportation market:

1. Transport Indemnity Co., a subsidiary of Mission Insurance Co, of Los Angeles, cancelled thousand of policies mid-term this summer, reportedly affecting over 2,500 carriers.
2. Excaliber Insurance Co.'s liquidation in December 1984 reportedly affected 3,000 carriers.
3. Carrier's Insurance Company of Des Monies, Iowa was recently subjected to Iowa State Department supervision, and ordered to stop writing or renewing insurance. Over 5,000 carriers are reported to have been affected by this company's questionable financial condition.

Several states have attempted to help carriers faced with cancellation of insurance or exorbitant increases. New Jersey, for instance, declared a state of emergency with regard to commercial liability insurance and the Governor's decision to prohibit insurers from cancelling or refusing to renew existing policies was upheld in court. Other states, such as Oregon, have enjoined insurers from cancelling policies mid-term and have taken action to ensure timely notice of non-renewals.

The Reagan Administration has appointed a special task force to study the problem. Entitled "The Tort Policy Working Group", it includes officials from 10 federal departments and agencies and the White House. (The ICC does not appear to be a participant in this working Group.) For a more extensive discussion of this approach, see the U.S. Chamber of Commerce's article in its November 1985 Washington Watch, annexed as Appendix 1 herein.

III. WHAT IS INSURANCE?

Andrew Tobias describes insurance in his best seller entitled "The Invisible Bankers", as follows:

"* * * the assets of the U.S. insurance industry—in excess of $700 billion in 1981—were greater than the combined worldwide assets of the nation's fifty largest industrial corporations. Only the banks sit steward over a greater share of American wealth. For, of course, most of that $700 billion doesn't belong to the insurance companies; it belongs to us. It is our collective savings against catastrophe, mishap, malfunction and misfortune.

"We deposit our money with insurance companies to assure nest eggs for our families if we die, money for a new house if ours burns down, cash to fix the car if ours is in a wreck. The insurance companies manage that money until we need it, lending it out to others in the meantime. Insurance companies are thus very much like savings banks-with one crucial difference: the amount of money any one of us may withdraw is based not on what he has deposited by way of premiums, but rather (within strictly defined limits) on what he needs. The aforementioned $700 billion that we have, as a group, saved up through private insurance companies comes to more than $8,500 for each of the nation's 82 million households. Hence, "the invisible bankers."

"Insurance is just a way of spreading financial risk from individual shoulders to the shoulders of us all as a group."

A serious problem develops, however, when an insurer, or the whole insurance industry, decides to exit from a specific insurance market (such as long-haul trucking) after having accumulated a sizeable fund of premium money intended to pay for future losses![1]

IV. THE COMMISSION'S ROLE IN INSURANCE

Although the McCarran-Ferguson Act of 1945 left regulation of the insurance industry to the states, Congress has properly delegated to the Interstate Commerce Commission the power to prescribe reasonable regulations with respect to the insurance coverage required of carriers, forwarders and brokers subject to its jurisdiction. The responsibility for setting the amounts of insurance required of carriers was transferred to the Department of Transportation in 1980. 49 U.S.C. 10927.

Minimum public liability and property damage insurance coverage is now prescribed in 49 C.F.R. 1043.2. Cargo insurance regulations are prescribed in 49 C.F.R. 1043.2(c) for common carriers and 1084.3 for freight forwarders. Surety Bonds for brokers are required and prescribed in 49 C.F.R. 1043.4, but these regulations relate only to the payment of freight charges to brokers, not to property loss or public liability.

Experience has demonstrated that the Commission's role in promulgating these regulations and providing information to the public with respect to specific carrier's and broker's insurance coverage has been one of the most beneficial functions of the Commission for the general public. The value of these regulations was vividly demonstrated by the spontaneous outcry from shippers protesting the Commission's proposal to repeal these regulations shortly after enactment of the MCA of 1980. Ex. Parte No. MC-5 and MC-159, 132 MCC 711.

Of greater significance to the public are the Commission's regulations which require all common carriers and freight forwarder insurers to file a cargo endorsement form making the insurer liable for all loss or damage up to $5,000 per vehicle or $10,000 per occurrence, irrespective of deductibles or exclusions in the carrier's or forwarder's policy (forms BMC 32 & 34; FF 32 & 34). These regulations have proven to be most beneficial during periods of financial instability in the transportation industry such as we are experiencing at the present time. (Dun and Bradstreet reported 1,400 carrier bankruptcies during 1984.)

A role which the Commission formerly fulfilled related to intervening on the public's behalf when a carrier's insurer arbitrarily and wrongfully refused to pay a claimant on behalf of its insured carrier. This valuable public service has greatly diminished due to the virtual elimination of Commission staff.

Another valuable regulation is the requirement that insurers give 30 days advance notice to the ICC before the cancellation of a carrier's policies may become effective. 49 U.S.C. 1043.7(d). This minimum cancellation period is often much longer than the cancellation period provided in the carrier's policies which commonly provide for 5, 10, 15 and 20 days notice. Therefore, the Commission's regulation results in carriers receiving at least 30 days advance notice of cancellation. Even with this amount of time within which to find replacement insurance, carriers have been hard pressed to arrange for new insurance.

In the event the insurer fails to file its cancellation notice with the ICC, its insurance coverage for the carrier continues to have effect as to the public, up to the BMC 32 limits. *Capital Rental Equipment Co.* v. *Pacific Indemnity Co.,* 193 F.Supp. 897 (W.D. Tex 1961).

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[1] See, for instance, the table at page 6 of Appendix 1, revealing that between 1981 and 1983, property/casualty insurers had a combined net income before taxes of $14.1 billion, but lost $3.8 billion in 1984, for a net profit of $10.3 billion over that four- year span.

Another valuable role played by the Commission in the public's interest was to monitor the insurance companies issuing insurance policies to carriers and Surety Bonds to brokers. Effective October 3, 1983, however, the Commission discontinued its approval process and delegated this function to the State Insurance Departments in which the authorized carrier's headquarters is located (49 C.F.R. 1043.8(b)). Therefore, at the present time, if an insurer is authorized to write insurance in a state, it is automatically qualified to write insurance for any carrier headquartered or domiciled in that state.

Thus, the Commission has lost its regulatory clout with insurers of transportation companies. Formerly, the Commission could influence an insurer to act responsibly with respect to claims by the public, in conformance with its regulations and BMC endorsement forms. The regulatory sword was the possibility of removal from the Commission's list of approved insurers.

Due to the Commission's lack of jurisdiction over insurers, they frequently deny coverage to claimants under the BMC 32 endorsement for a variety of reasons, most of which are improper.

For instance, insurers, through their attorneys, have attempted to deny liability on grounds that:

1. When a shipment has been replaced by the manufacturer, the carrier is not liable for the invoice price. Insurers are offering instead to pay only the "manufactured cost". This arbitrary position ignores the landmark decision of *Polaroid Corp.* v. *Shuster's Express,* 484 F.2d 349 (1st Cir. 1973) and the fact that common carriers are liable for "full actual loss" as provided in the Carmack Amendment (49 U.S.C. 11707).
2. Insurers' obligation under the BMC 32 form does not cover "Fob origin" shipments, claiming that the shipper had no insurable interest in the shipment after it was placed in the control of the carrier.
3. Refused or rejected shipments are not covered by the BMC endorsement as the transportation has ended on tender of delivery, and therefore the insurer's liability under the BMC 32 endorsement has ended.
4. "Free astray" returns to a shipper by the carrier are not covered by BMC 32 forms.
5. Improper packing, packaging or markings, are causes of damage which are not a carriers liability, without offering specific evidence of such alleged improprieties. (The mere fact that a shipment suffered damage in transit is not prima facie evidence that the packaging was at fault.)

Without the Commission's exercise of its former regulatory powers over insurance companies, the Council fears that the shipping public will not receive that same degree of assistance and cooperation from 50 State Insurance Departments, particularly with respect to the uniform application of insurance regulations.

IV. REGULATORY SOLUTIONS

Contrary to the belief in some quarters, the Commission has the power to address some of the problems being experienced by the transportation community with respect to insurance coverage and costs. For instance:

1. The Commission's staff can be strengthened to monitor insurance filings, provide current information on carriers' insurance coverage to the public and to revoke outstanding certificates and permits held by carriers and brokers not in compliance with insurance regulations.
2. The Commission's field staff can be strengthened to detect and prevent operations without the prerequisite insurance coverage and to establish reciprocity agreements with State Insurance Department and law enforcement agencies.
3. The Commission can restore its function of monitoring the financial condition of the insurance companies and sureties serving ICC authorized carriers. This would appear to be necessary to restore the Commission's clout in dealing with insurers with respect to their unreasonable claim practices.

At the very least, the Commission should issue a public notice informing the public that it is no longer monitoring the financial condition of insurers of carriers and forwarders under its jurisdiction. The notice should include a list of the state insurance departments, including the name, address and telephone number of the official to contact for information on or complaints regarding any particular insurer. As an example, a list of the State Commissioner's of Insurance is annexed hereto as Appendix 2. To be of greater practical benefit to the shipping public, this list must be fine-tuned to permit direct access to the official charged with responsibility for insurers of carriers.

4. The Commission should consider imposing reasonable limitations on insurance policies issued to carriers with respect to the term of an insurance policy and increasing premiums during that term. For instance, virtually all policies are written for a one-year term and premiums are based on that period. However, all policies contain an escape clause permitting the insurer to cancel the without cause on short notice (mid-term). These notice periods range from 5 to 30 days. See Appendix 3 for typical cancellation clauses in cargo and liability policies.

In order to establish much needed stability in this area, the Commission should require that policies be binding on the parties thereto for a minimum of 12 months and that any cancellation thereof, except for non-payment of premiums, be prohibited unless notice is received by the Commission 60 days prior to the first anniversary of the policy. The 60 day period is necessary today within which to find another insurer willing to insure the carrier.

Increases in the premium schedule provided for in the 12 month policy must also be prohibited during its term.

5. Another area of intervention which relates to public notice concerns the popular "Certificate of Insurance." Unfortunately, most shippers are led to believe that its holding of such a certificate is a guarantee of insurance coverage for that carrier. Experience reveals, however, that this is often untrue. The reasons are:

a. "Certificates of Insurance" do not reveal the causes of loss which are covered by the policy or the many exclusions from coverage.

b. There is no legal obligation on the part of the insurer to notify the certificate holder (shipper) of a cancellation or modification of the policy.

c. "Certificates of Insurance" are occasionally issued by the carrier's insurance broker, (who is acting as the carrier's agent) not by the insurer and therefore, are not binding on the insurer.

d. "Certificates of Insurance" are occasionally issued fraudulently by unauthorized persons, such as carriers, property brokers, shippers agent, etc.

In view of the fact that such certificates are issued for the purpose of inducing a shipper to route its traffic via the carrier named in the certificate, the Commission should prescribe certain changes in such certificates and mandate their use in all certificates issued by insurers of authorized carriers to the shipping public. Each of these four areas of concern will be addressed, with recommendations for remedial action hereinafter:

(a) Annexed hereto as Appendix 4 is a typical "Certificate of Insurance". Note that the form lacks a specific box for cargo insurance. Nor does the form provide for an explanation of the type of cargo coverage or the exclusions from coverage.

Although this particular form tells the shipper that there is $500,000 of "All Risk" insurance, subject to policy terms and conditions, and a $1000 deductible, the certificate does not explain what conditions are not covered.

The Council has identified 94 standard exclusions found in "All Risk" policies currently in use throughout the cargo insurance industry. See Appendix 5 herein, which is a checklist from the Council's latest text entitled "Transportation Insurance in Plain English". Obviously, not all 94 exclusions are contained in every "All Risk" policy, but all such policies contain some of these exclusions.

The point is that many shippers take a certificate of insurance at its face value and believe that the carrier for whom the certificate was issued is covered for "all risks". These shippers are induced to do business with the carrier, and later discover that

(1) All such policies contain important exclusions from coverage, and

(2) There is no "standard" "all risk" policy form, as each insurer writes its own terms and conditions.

For instance, a food manufacturer may discover that its refrigerated products were not covered for "mechanical breakdown". A camera manufacturer may discover that the carrier's driver was involved in the theft of a half million dollars worth of its cameras, and therefore, the carrier is not covered due to the "dishonesty or infidelity" exclusion.

To prevent this type of deception, the Commission is urged to promulgate a new regulation requiring the use of standard provisions in all Certificates of Insurance issued by insurers of carriers and forwarders subject to its jurisdiction.

In the box for "Limits of Liability", the insurer should be required to add to the limits and deductible a reference to an attachment setting forth a copy of the "coverage" and "exclusions" clauses in the carrier's policy. It may also be advisable to require that a copy of the entire "Terms and Conditions" section of the policy be annexed to the certificate. This will serve to notify the shipper of other important limitations in the policy which frequently result in the discovery that the carrier is not insured for the full loss. See, for instance, the requirements for notifying the insurer of potential claims, the co-insurance clause, the impairment clause, the average value clause, the depreciated value clause, etc. in Appendix 6 herein.

(b) The "Cancellation" clause in certificates of Insurance generally read as follows:

"Should any of the above described policies be cancelled before the expiration date thereof, the issuing company will endeavor to mail ——— days written notice to the below named or certificate holder, but failure to mail such notice shall impose no obligation or liability of any kind upon the company."

The shipping public rarely reads the "fine print" in printed forms which have a "boilerplate" appearance. The public generally does not realize that this "certificate" does not create a legal obligation on the part of the insurer to notify the shipper of a cancellation or material change in the policy referred to therein. Nevertheless, in reliance upon such a certificate, a shipper will continue to route its traffic via the named carrier in the erroneous belief that the carrier is fully insured for all cargo losses.

To rectify this widespread misconception, the Commission should mandate the use of the following clause in all Certificates of Insurance issued by insurers of carriers and forwarders under its jurisdiction.

"Should any of the above described policies be cancelled before the expiration date thereof, the issuing company will mail 30 days written notice to the below named or certificate holder".

Such a requirement will standardize the amount of advance notice to shippers, and will conform this notification to the Commission's notification regulations in 49 CFR 1043.7(d).

However, if the Council's request to change the notice requirement to 60 days prior to the first anniversary is adopted, this time period should be incorporated in the Certificate of Insurance also.

(c) To assure the issuance of certificates by insurance brokers acting as agents for the carrier, the Commission should require that such certificates be issued only by the insurance company providing the coverage, or its authorized agents.

(d) To prevent the issuance of certificates by unauthorized persons, or their issuance when the insurance coverage stated therein is not actually in effect, the Commission should add monetary fines and criminal penalties. The fraudulent issuance of certificates has been reported to the Council as a growing problem among carriers and brokers.

It would also be advisable to add a statement to the effect that certificates of insurance issued fraudulently or in violation of these regulations may give to parties relying upon such certificates a cause of action for damages resulting therefrom.

Each of the foregoing changes in regulations could be promulgated under the Commission's statutory powers granted in 49 U.S.C. 10927.

V. LEGISLATIVE SOLUTIONS

In addition to the administrative remedies suggested hereinbefore, the Commission can play an important role in formulating recommendations for legislative initiatives.

Congress has already decided that the public interest requires that all highway operations be insured in prescribed minimum amounts. 49 U.S.C. 10927. However, regulation of the insurance industry was left to the states. 15 U.S.C. 1012. It would appear that current developments dictate that Congress re-examine this decision to determine whether the public interest would be better served by modifying this policy.

Many of the benefits of deregulation are being eroded by the uncontrolled actions of the insurance industry. Carriers are being forced to close their doors due to exorbitant, unprecedented increases in premiums, unavailable coverage or unrealistic deductibles and exclusions. The worst crisis may be faced on January 1, 1986 when reinsurance becomes generally unavailable to carriers subjected to "environmental restoration" expense.

Insurers are presently free to exit from the transportation industry after having reaped the benefits of decades of insurance premiums paid by carriers. Uncontrolled entry into and exit from the insurance industry is clearly one of the fundamental causes of the current crisis.

The decision by certain insurers to refuse coverage to the trucking industry when their losses from other insured industries are greater than expected is analogous to investors' take-over of public transportation companies for the sole purpose of liquidating their capital surplus accounts which were built with years of profit, and intended to finance new transportation equipment. The public is the victim in both instances.

The trucking industry and shippers have paid billions of dollars to the insurance industry in the past for protection against catastrophic losses. Congress must protect their vested interest in this insurance fund if the insurance industry refuses to act responsibly and in the public interest.

Others in the insurance industry appear to recognize that federal intervention is a distinct possibility if the industry does not respond to the crisis created by major insurers exiting from selected insurance markets. See, for instance, the Editorial in the September 23, 1985 issue of Business Insurance, annexed as Appendix 7.

Despite his frank appraisal of the cause of the crisis, the editor fails to appreciate some of the legal concepts involved. For instance, contracts of insurance are adhesion contracts, and therefore, must be judged with consumer protection in mind. Obviously, the insurance industry would prefer having its boilerplate, fine print policies strictly interpreted by the courts, knowing full well that they have been carefully drafted and fine-tuned by their lawyers following every adverse judgement against them.

As distasteful as more federal regulation may be in the current regulatory cycle, it is clear that only an expression of Congressional intent to seriously consider regulating insurers will bring about voluntary action by the insurance industry.

Federal controls over entry and exit would not be a case of forcing insurers to write unprofitable business, as the industry claims. It would be an expression of public policy mandating coverage of all risks at reasonable rates dependent on experience. It would be an equitable solution to the problem created by a combination of federally-mandated insurance coverage without sufficient restraints on insurers to prevent abusive actions contrary to the public interest. Reasonable, uniform regulation of transportation insurance terms and conditions would be an extension of Congress' commitment to consumer protection.

In sum, the insurance industry invited federal intervention by its irresponsible actions. Now that interest rates have declined, the industry must return to sound underwriting practices, but not at the expense of shippers and carriers who have been contributing to the industry's huge profits for decades.

There are indications that the insurance crisis may be short-lived, and that many insurers have over-reacted.[2] It is also believed that recent actions by the industry were calculated to pressure the states to change their laws by imposing limitations on manufacturers' and professionals' liability exposure. Similar tactics worked well for insurers in the mid 1970's.

At any event, Congress should be pressured to intervene in the interest of preventing any further hardships on the transportation industry and interruptions in vital transportation services.

Specifically, consideration should be given to federal regulations designed to:

(1) Set guidelines for state regulation of insurers with regard to exit and entry in transportation markets.

(2) Require all insurance companies to write insurance policies for interstate carriers' cargo, public liability and property damage.

(3) Prevent cancellations or premium increases during a 12 month policy period, except when the premium is not paid on schedule.

(4) Establish uniform financial standards for insurance companies.

(5) Prescribe uniform terms for transportation policies when necessary to protect the public from misleading terms and unreasonable practices.

(6) Monitor the amount and frequency of increases in premiums for the purpose of spreading catastrophic losses over a longer time frame.

(7) Consider tax incentives designed to foster sound underwriting practices and to discourage entrepreneurs interested only in attracting premium income when interest rates are high, and to

(8) Encourage the expansion of a U.S.-owned reinsurance industry to diminish our dependence upon the London-based reinsurance market.

CONCLUSIONS

The insurance crisis appears to be a problem of major dimension, and one which threatens to reverse all of the gains achieved by The Motor Carrier Act of 1980.

The fundamental problem appears to relate to the insurance industry's freedom to accumulate billions of dollars of profits from premiums paid by carriers for decades without regulatory constraints on the future application of this massive insurance fund.

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[2] See report on third quarter earning of property/casualty insurers annexed as Appendix 8.

The obvious solution is for the federal government to impose some restraints on the insurance industry to augment the ineffective patchwork of state regulation presently monitoring the industry.

As distasteful as this solution may be to the insurance industry and to marketplace economists, those public officials who are charged with the responsibility to regulate and foster a sound transportation system in this nation must recognize the futility of expecting this crisis to be resolved voluntarily by the marketplace.

Although the transportation industry is only one of the many victims of insurers, the Commission must take a leadership position in recommending administrative and legislative solutions for the transportation industry. Its responsible actions may then provide a basis for Congressional solutions for all affected industries.

STATEMENT OF LEONARD D. GOODSTEIN, PH.D., EXECUTIVE OFFICER, THE AMERICAN PSYCHOLOGICAL ASSOCIATION

Mr. Chairman and Members of the Committee, the American Psychological Association (APA) is pleased to have the opportunity to testify on the effect of the professional liability insurance crisis on the profession of psychology. The APA represents over 76,000 psychologists, with affiliated State Psychological Associations in each of the 50 States, the District of Columbia, Puerto Rico, and Ontario. We share the concerns of the Congress, the public, and other health care providers over the growing crisis in the areas of malpractice insurance and general liability insurance.

In some general ways, the current insurance experience of psychologists parallels that of physicians in that we are both plagued with the problems of affordability and availability of insurance coverage as evidenced by a recent epidemic of policy cancellations, reduced numbers of insurance carriers, and steep increases in malpractice insurance rates across the country. However, the problems experienced by psychologists also differ in significant respects from those of the rest of the health care community. Of particular concern to the profession of psychology are changing public attitudes and new legal interpretations which reflect a growing trend toward expanding therapists' liability for professional decisions (e.g., recent case law has imposed a duty on therapists to predict the future violent behavior of patients and to protect third parties of potential harm). Thus, in the absence of Congressional or state legislative activity, psychologists are faced with an increased potential of legal action as well as increased insurance costs.

We believe the Congress must have before it a comprehensive view of the nature of the problem and the ramifications of any proposed solutions considered for each of the health care provider groups that would be affected by Congressional action in the insurance area. For example, the bill (S.1804) recently introduced by Senator Orrin Hatch (R-UT) to provide for Federal incentive grants to encourage State health care professional liability reform defines the health care professional broadly to mean "any individual who provides health care services in a State and who is required by State law to be licensed or certified by the State to provide such services in the State." We agree that any reform at the state or federal level should extend to all health care providers, but the formulation of state and federal policy must also contemplate the differences among relevant professions. But such documents as the report, "Medical Malpractice—No Agreement on the Problems or Solutions," published by the General Accounting Office (GAO) in February, 1985, approach the malpractice question solely from the physician's viewpoint. The following information is intended to give the Congress greater insight into the unique difficulties encountered by mental health professionals in obtaining malpractice coverage over the past few years.

In 1984, those psychologists insured through the professional liability program sponsored by the APA Insurance Trust (about 50% of APA's membership procures insurance through the Trust) were paying an annual premium of $50 for $1,000,000 coverage. Last year the annual premium increased an astonishing 600% to $300, and this year we have witnessed an additional 50% increase to $450. Not many years ago, the claims experience for psychology was so excellent that the premium was actually reduced. It is not surprising that many APA members have expressed serious concerns over these enormous rate increases.

Yet by comparison to physicians, the cost of malpractice insurance for psychologists may still appear affordable. However, the median income for psychologists whether engaged in private practice or employed full- or part-time in university, health care, or industrial settings is substantially lower than for their medical counterparts. Moreover, those psychologists who provide mental health services on a part-time basis while working in a university setting, for example, are required to pay the same rates as full-time practitioners. It should be noted, however, that insurance covers all professional activities, including teaching, research and employee selection, and is not limited to clinical practice.

Prior to 1982 the level of indemnity for psychology was admirable. In 1982, however, there were several large awards against psychologists which may have contributed to the increases witnessed in recent years. Further, several major liability carriers have dropped psychology or are refusing to write new policies for psychologists. In fact, as of November 1985 there remained only one national insurance carrier offering coverage to psychologists. New carriers contemplating underwriting psychology are considering specific exclusions including office accidents, sex-related cases, suicidal risk, and injury to third parties.

We want to emphasize that recent developments in insurance coverage do not reflect an increased number of law suits brought against psychologists. Quite the contrary—a review of the 10-year claims history of the APA Insurance Trust reveals that the chances of being sued are less than ½ of 1% for psychologists. Further, the vast majority of the suits brought against psychologists are resolved at reasonable cost levels. According to data derived from the Trust, 80% of the 939 claims brought over the past 10 years resulted in payments of under $10,000, with only 60 claims over $100,000 and only one to three claims (settled and pending) for $1,000,000. A few suits, however, usually involving sexual misconduct, have resulted in large awards which have contributed to the increased costs of insurance premiums. In response, the APA Insurance Trust set a new coverage limit for sexual misconduct cases of a $25,000 maximum. Further, the claims against psychologists for misdiagnosis have been minimal.

Nonetheless, insurers argue that it is extremely difficult to insure for psychological malpractice because of the "tail-of-the-risk" phenomenon—a situation where a "malpractice" event takes place in 1980, for example, but a claim is not filed for several years—and difficulty in defining risk associated with psychological services. In this regard, it is critical that psychologists be provided with an occurrence policy as described above, rather than a claims policy, to insure against suits for alleged misconduct in prior years.

It has been suggested that part of the solution to the malpractice problem for health care providers is more intensive and active pursuit of incompetence by the professions themselves. APA shares the view that the professions have a responsibility to self-police and enforce the profession's ethical standards. The APA and the State Psychological Associations have Ethics Committees that seriously undertake this responsibility. While more rigorous self-policing is suggested as one means of addressing the malpractice insurance problem, APA and its State Associations are faced with intolerable increases in the costs of association liability coverage. Previously, State Associations typically paid premiums of $750 to $1,250 for a $1,000,000 association liability policy with no deductible. Last year the premium rose to $2,500. This year, premiums are approximately $5,000 for a $250,000 policy with a $7,500 deductible. We want to point out that this has occurred in the absence of any successful suit against any State Psychological Association.

The State Psychological Associations are financed by member dues. Naturally, the smaller states with fewer psychologists have very limited resources. Many of them have expressed not only an inability to afford the increased premium but an inability to afford the deductible. Should increased insurance costs force our State Associations out of the business of peer review and ethics enforcement, the salutary effect of the profession's ability to play its part in alleviating the malpractice crisis will be seriously undermined.

In addition to our belief that some changes are needed in the current system to obtain insurance at reasonable rates, psychology is also pursuing changes in the substantive law at the state level in order to limit psychologists' liability in certain circumstances. One such area involves the issue of psychologists' ability to predict the dangerous acts of their patients. Legal action on this issue dates back to the 1970's when we began to see psychologists, psychiatrists, and mental hospitals held civilly liable for the violent acts committed by their patients. The most publicized case is the 1976 California Supreme Court decision in *Tarasoff* v. *Regents of the University of California.*

In *Tarasoff*, a patient made overt threats of violence against his girlfriend while he was receiving therapy as a voluntary outpatient at a university hospital. The mental health professionals initially involved in this case (one psychologist and two psychiatrists) pursued involuntary commitment proceedings by contacting the university's campus police, who in turn picked up and briefly detained, but then released, the patient. The therapists in this case did not attempt to warn the girlfriend or her family, and the patient killed her two months later shortly after her return to this country.

In holding that the victim's parents could sue the therapist for damages, the California Supreme Court created a new cause of action that has since become the tip of a civil liability iceberg. The court said that:

> * * * Once a therapist does in fact determine, or under applicable professional standards reasonably should have determined, that a patient poses a serious danger of violence to others, he bears a duty to exercise reasonable care to protect the foreseeable victim of that danger.

The California state courts extended this duty in subsequent cases to include persons in "close relationships" to potential victims who might also be in danger. More alarming are decisions by courts in other states that extend the psychotherapist's duty to require "reasonable precautions to protect anyone who might foreseeably be endangered by" an ex-mental patient's behavior (e.g., Washington—a public hospital was held liable when a patient took angel dust five days after discharge, and injured a woman in a car accident; Nebraska—a V.A. hospital was held liable when a patient fired a shotgun into a crowded dining room 40 days after his discharge against medical advice).

These new duties imposed on psychologists and other mental health professionals—to predict the dangerousness of the patients they treat, and then to protect whomever might be harmed by those patients—are inconsistent with many of the demands of the psychotherapeutic relationship and the skills and training of mental health professionals. No diagnosis or treatment for "dangerousness" exists in psychology or psychiatry, and little in the education and training of these and other mental health professionals equips them to predict future violence nor do they claim to be able to predict future violence. Statistical or actuarial approaches to such predictions, based solely on police records, have been shown consistently to be as good or better than any clinical model.

The result of this "duty to protect" is that many individual practitioners now report greater reluctance to treat dangerous persons. The only research to date on the effects of warning potential victims has found no difference in the incidence of subsequent attacks, but less reported improvement in therapy. Psychologists in several states are working to enact laws that will limit the liability of psychotherapists for violent acts committed by mental patients. Psychology is working to better inform both the legislative and judicial branches of government on what therapists can and cannot do. Neither psychologists nor any other mental health professionals can reliably predict future violence. We believe it is critical that the tort system reflect this reality.

We appreciate the efforts of the Congress and this Committee to bring the costs of malpractice insurance under control and to assure the availability of adequate insurance to health care professionals, while balancing the need to protect consumers from substandard care and to ensure that they are appropriately compensated when injury occurs. This need becomes all the more pressing in response to the changing nature of the health care system which includes an increase in alternative service delivery models like health maintenance organizations. We understand that the Committee will consider a range of substantive and procedural proposals to achieve these goals, such as moving from a fault-based to a no-fault-based system of compensation; limiting tort liability through federally encouraged state law reform; removing the insurance liability industry exemption from the federal antitrust laws; having the federal government serve a reinsurance function in cases where businesses or professions cannot obtain insurance; and providing for the option of associations offering direct insurance with the federal government serving to reinsure. We hope that the Committee will regard APA and its affiliated State Psychological Associations as a valuable resource in terms of our research and clinical experience in your ongoing deliberations concerning these issues. We thank you for this opportunity to testify.

STATEMENT OF THE CHEMICAL MANUFACTURERS ASSOCIATION

I. INTRODUCTION

The Chemical Manufacturers Association (CMA) is a non-profit trade association whose members represent more than 90 percent of the productive capacity for basic industrial chemicals in the United States. Chemical industry products are shipped and used throughout the United States. Many of the chemicals manufactured by industry members are used in the workplaces of other manufacturers where they become ingredients of downstream products.

As with other industries, professionals, and state and local governments, the chemical industry is facing an insurance crisis of significant concern. We are seeing rate increases of multi-hundreds of percent, severe shrinkage of capacity so that some companies have no liability insurance at all, and self-assumed layers of insurance approaching tens of millions of dollars. Some forms of insurance have disappeared altogether, such as pollution insurance, both gradual and sudden and accidental.

This crisis finds its roots in a deteriorating business climate for insurance companies. It includes deteriorating loss ratios, declining investment income, escalating liability claims, disappearing reinsurance support, and poor business judgment by the insurance industry by engaging in "cash flow" underwriting. Add to these problems the liability provisions of the Comprehensive Environmental Response, Compensation and Liability Act (CERCLA), insurance requirements of the Resource Conservation and Recovery Act (RCRA), changing government regulations and changing court attitudes, and varying perceptions of the chemical industry and you have a crisis expected to last well into 1987 and—very possibly—longer.

It should be apparent that the corporate community, including the chemical industry, cannot meet its legal responsibilities through the purchase of commercial insurance. Due to economic and legal factors which have received widespread media attention, commercial insurance either is not available or is available at a cost beyond economic feasibility.

There are few solutions from traditional insurance sources. The best avenue may be found in the several developing pooling arrangements. Unfortunately, even these arrangements fall short of providing all the coverage being demanded, nor do they defer the large price increases that are occurring.

Indigenous problems of the insurance industry are not alone in the making of this dilemma. They are only the catalyst. Indeed, the loss history for insurers continues to deteriorate especially in the "third party" insurance lines such as general, products, and automobile liability. We are all familiar with an increasing propensity to sue, social entitlement, and extension of obligations to protect health and the environment. In many cases, our financial obligations fall on the shoulders of the insurance industry. This is not new, as these concerns were recognized by the insurance industry in the mid-1970's. However, those concerns were overshadowed by an infusion of new capital from captive insurance companies, foreign insurers, and businesses in the mid-1970's that wanted to get into the financial services industry. This led to a soft insurance market for years.

Increasing demands on insurance companies, coupled with what insurers believe is an overly broad interpretation of contract language by the courts, have led to the present emotional underwriting posture of the insurance industry. The tragedy in Bhopal, India, was not the cause. It merely brought up previously overlooked underwriting risks. Add increasing litigation in general, a lack of faith in the insurance contract, poor financial results, an inability to transfer risks to someone else, and business mistakes within the insurance industry and you have today's crisis.

II. IMPACT ON THE CHEMICAL INDUSTRY

The most appropriate phrase to describe the impact on the chemical industry is probably "red lining"—catagorically refusing coverage on the basis of our industry and not on individual characteristics. Many reinsurers have indicated they will not insure certain classes of businesses and the chemical industry is one. Once the reinsurers stopped writing chemicals, primary carriers either stopped writing us altogether or severely restricted how much coverage they would offer. The potential risks of chemicals and long-term effects have created an actuarial nightmare. How can one price a risk today and get an adequate premium if one can't anticipate the impact of a worsening legal climate?

In 1985, many chemical companies saw rate increases of 200, 300, and even 400 percent. There was also a major drop in the amount of insurance that could be purchased at any price.

One of our major companies had its premium increase 300 percent last year for less than one-half the coverage. Another major company paid 400 percent more for one-fourth the coverage. Yet another of our companies had approximately $150 million in comprehensive liability coverage. In 1985, even though this company had experienced no claims in the last six years, its policy was not renewed.

In addition to the price increases, we are experiencing a loss of coverage. The insurance industry is now imposing new coverage language, known as "claims-made" policies. These policies will pay for claims the year they are presented as contrasted with "occurrence" policies which pay for losses based on the date of the incident. Most insurance buyers believe the "claims-made" policy is a major restriction in coverage.

III. POSSIBLE SOLUTIONS

A. Traditional insurance: London market and other international insurers

As far as traditional insurance is concerned, there is little if any coverage currently being written for chemical risks. In the excess market, the London market has upwards of $10-20 million in capacity at different layers, and could very well be the cornerstone of any excess insurance program. London's unique posture of writing chemical accounts, however, has created a long waiting line to see key underwriters. In addition, their new and varied policy forms raise some questions as to the adequacy and appropriateness of coverage provided.

International insurers are extremely afraid of the U.S. court system. Therefore, they have not rushed into the U.S. market to fill the void and are not expected to in the foreseeable future.

B. Traditional insurance—U.S. markets

As far as U.S. insurance companies are concerned, perhaps a half dozen still insure chemicals. Others consider chemicals if they also write primary coverage or have other unique considerations. Additionally, the forms, underlying limit requirements, premiums, and inability to add new business this underwriting year are all subjects of concern and consequently insurance may be unavailable for any particular risk.

C. Self-insurance

Self-insurance is an alternative. As an alternative to insurance, self-insurance could be the least attractive option because of an inability to take tax deductions for losses until they are paid. Also, how much should be set aside to budget for losses is of major concern.

Self-insurance opens up new areas of financial concerns, including instability of operating results and earnings, stockholder dissatisfaction, and debt capacity concerns. The costs of internal claims administration, including impact on accounting, legal, claims control and loss control are all issues to be considered. However, many choose self-insurance because of better control of claims, good control of cash flow and other perceived benefits.

D. Pooling, captives, and joint venture insurance alternatives

Of great value, though long-term with respect to a capability to solve the insurance crisis, is pooling with other companies and captives. There are currently several companies who have banded together to look into setting up captives or pooling arrangements. However, these groups provide coverage at a catastrophic level—usually $50-$100 million—which mid-size and small companies cannot meet.

IV. CMA ACTIVITIES IN RESPONSE TO THE INSURANCE CRISIS

CMA has taken a number of steps to help our companies address the insurance crisis. These steps include participation in product liability reform efforts, service on an advisory committee exploring the environmental liability insurance problem and creation of a new CMA committee to collect and share information on insurance matters. Following is a discussion of these areas.

A. Product liability

CMA has been an active participant in recent product liability reform efforts. These reform efforts have resulted from a continuing expansion of industry's exposure to product liability judgments. This expansion has gone so far that the courts are clogged, reasonable casualty insurance is unavailable and a business can be unjustly ruined by liability without fault or causation, punitive damages and class actions.

Product liability has emerged as a costly impediment to interstate commerce. Uncertainties and imbalance in the product liability tort litigation system will continue in the absence of a uniform statute enacted at the Federal level.

CMA believes product liability reform is needed and overdue. Throughout our participation in reform efforts, CMA has sought to preserve and perfect the traditional fault based product liability tort law system as a fair means of compensating those who have suffered wrongful injury. At the same time, CMA has strongly opposed liability without fault, and particularly liability without causation, whether in the tort law system or some other liability scheme. Our views on product liability reform and S.1999, the Product Liability Voluntary Claims and Uniform Standards Act, were presented at the recent Senate Consumer Subcommittee hearing of the Senate Commerce, Science and Transportation Committee.

B. NAIC advisory committee on environmental liability insurance

The National Association of Insurance Commissioners (NAIC) is conducting a study of the issues relating to environmental liability insurance. To assist in the study effort, an Advisory Committee has been formed consisting primarily of representatives from insurance companies and their trade associations. CMA is one of two industrial groups represented.

The Advisory Committee's goal is to address the criteria for a viable insurance market. CMA hopes to be of assistance in gathering information on the impact of the proposed recommendations, and to work with the Committee to ensure a balanced final report.

C. Special committee on insurance

In response to our members' concerns regarding the current insurance situation, CMA has formed a Special Committee on Insurance. This Committee will provide a forum within the chemical industry for the collection and sharing of information on insurance matters and for exploring options for resolving the unavailability of insurance.

V. RECOMMENDATIONS FOR CONGRESSIONAL REVIEW

CMA believes that Congress must address the insurance crisis. To help alleviate this crisis, we propose the following recommendations for Congressional review.

A. Reform of the Nation's product liability laws

The Consumer Subcommittee of the Senate Commerce Committee recently completed two days of hearings on product liability. The testimony of witnesses at these hearings demonstrated that the need to reform our nation's product liability laws is widely recognized.

The present product liability system is breaking down under the weight of excessive litigation, exorbitant legal fees and unreasonable damage awards. The expansion of product liability has gone so far that reasonable casualty insurance is unavailable.

It is time for Congress to reform our product liability laws. A fair and balanced uniform product liability law would help bring our runaway liability system under control.

Such a bill should include a fault-based standard for judging the adequacy of product design and the appropriateness of safety warnings. It should provide a clear presumption that a product meeting government safety requirements is reasonably safe. It should adopt the principle of comparative responsibility so that damages reflect the extent to which plaintiffs contributed to their own injuries. And it should limit punitive damage awards, which in recent years have become subject to jury abuse. We believe these changes would make a significant improvement in the current product liability system and would improve the outlook for insurance.

B. Tax deductibility of self-insured reserves

Since commercial insurance either is not available to the corporate community or is available only at a prohibitive cost, companies must explore other options to cover their legal obligations. To help companies meet this challenge, Congress should facilitate the use of these other options.

One important option is self-insurance. As mentioned earlier, however, this option is limited because of an inability to take tax deductions for losses until they are paid.

We urge Congress to reform the Tax Code to permit corporations who elect to self-insure, either through a captive insurer or through reserves for expected losses, to deduct these reserves. A self-insurance reserve would almost always be less than the cost of commercial insurance, due to the reduced costs of overhead, profit, commissions and taking into account current insurance premiums. Therefore, allowing a corporation to deduct its self-insured reserves should result in lower costs to the corporation and increased revenues to the government. As reserves of the corporate self-insured, as they are actuarially established, and the commercial insurer serve the same purpose and are subject to the same claim liability, there is no rational reason for differentiating between them for tax purposes.

C. Review uninsurable liabilities in existing laws

Recent federal environmental legislation has changed many of the basic principles of tort law. CERCLA in particular departs from these traditional tort principles, imposing virtually absolute retroactive liability upon parties whose actions may have been completely lawful at the time they were taken. Moreover, courts have almost uniformly upheld the government's position that CERCLA permits imposition of joint and several liability when the damages are indivisible. Thus complete recovery may be had from any one of the responsible parties.

Industry and its insurers could not foresee the novel principles of liability deriving from CERCLA and similar legislation. Under some circumstances, CERCLA may make liability a virtual certainty. This has led insurers to believe that environmental risk is uninsurable.

Congress should carefully study any new legislation to make sure that the liabilities being imposed are insurable. Further, it should carefully review existing legislation with a view toward creating insurable liabilities.

STATEMENT OF WILLIAM M. QUINN, AMERICAN SUPPLY ASSOCIATION

Mr. Chairman: My name is William M. Quinn of Memphis, Tennessee. I am President of General Pipe and Supply Company and Chairman of the Government Affairs Council of the American Supply Association. ASA is the national trade organization for the plumbing-heating-cooling-piping industry, most of which are small, family-run businesses.

As a plumbing-heating-cooling-piping wholesaler and officer in my national association, I have had considerable discussion with business associates and fellow wholesalers on the alarming increases in insurance premiums and reductions in insurance coverage that have occurred nationwide. We can provide a vast body of anecdotal information on businesses that have experienced huge increases in liability insurance premiums, that have been denied coverage or face termination of their policies, that have been forced to self-insure and thereby jeopardize assets that have been accumulated over several family generations, or that will simply go-out-of-business rather than face continued risk or depletion of their businesses. We are confident that the committee will receive these kinds of examples from the witnesses called before you today, not only from my own state of Tennessee but from throughout the nation. Stories of the calamity in insurance protection abound and plainly illustrate the crisis facing small businesses today.

For its part, ASA has attempted to gather data from throughout its membership and quantify those results in a manageable form. Our results come from over two hundred wholesale businesses located throughout the 50 states. The response from our members confirm what we have heard individually and duplicates the experience of many other hard-pressed industries. The results can be summarized as follows: a large majority of ASA members indicated that they were experiencing substantial increases in premiums in

	Percent
Commercial auto and truck insurance	86.3
Property and casualty insurance	78.8
Product liability insurance	76.9

Further, for officers and directors liability insurance (which only applied to 40% of the responding companies, due to the nature and size of our businesses), 61.5% of our respondents experienced increases. The median increase in premiums for all types of coverage was 50%.

In recent years, we have taken a particularly close look at product liability coverage, a problem which is illustrative of trends throughout the insurance industry. As wholesalers, we are product sellers rather than manufacturers. In most instances, we function as a distributor, in the truest sense of the word. We have little to do with the product beyond transportation, storage and sale. Only under unusual circumstances do we become involved in any transformation or assemblage of a product during the period that it is in our control. Yet we are being sued, and less frequently held financially responsible, for harm that has resulted from the use of that product. This we attribute to our legal system, which employs a Robin Hood mentality to compensating victims. The logical progression and application of product liability to our industry was recently noted by John McDonald of the Brock-McVey

Company of Louisville, ASA's former President and Chairman of the Board. McDonald notes insurance industry statistics that most accidents occur in close proximity of the home. Of these, the vast majority of injuries occur in the bathroom, where, in turn, a vast majority occur in the shower or tub. In this illustration, McDonald is being somewhat facetious, but only to a point and his conclusion has an increasingly ominous ring to our members. In a no-fault legal environment where plaintiffs and juries look to the availability of funds for a judgment—the so-called "deep pocket"—plumbing-heating-cooling-piping wholesalers can expect increased exposure and a continuing upward spiral to premiums. Manufacturers, wholesalers and contractors know that, irrespective of provision for safety devices, a danger that has been known to man for centuries—getting in and out of the tub—can be become the legal cause of action that drives our members out of business in the 1980s.

In our survey, plumbing-heating-cooling-piping wholesalers first point to the symptoms—higher premiums—but time after time mention the root cause of the problem to be the legal system. It is this problem that we seek to address: reform of the tort system. We well understand that there are elements of this task that appropriately should be assumed at the state-level. However, this is a national problem that spans states' boundaries and permeates all of interstate commerce. It is a national small business issue, a commerce issue, a judicial issue and an economic issue. We urge your committee to move past the symptoms of this crisis—which we join other national organizations in reaffirming as exactly that, a crisis—and take a comprehensive look at how Congress can appropriately reform the tort system. We will have specific recommendations as you move ahead with your deliberations and look forward to working with you towards a solution.

Our survey results follow and, with the permission of the Committee, are incorporated in our testimony.

STATEMENT OF TED J. BALESTRERI, CHAIRMAN OF THE BOARD AND PRESIDENT, NATIONAL RESTAURANT ASSOCIATION

Mr. Chairman, thank you for the opportunity to submit a written statement for the hearing record regarding the server difficulty, crisis if you will, that foodservice operators are having in obtaining affordable liquor liability insurance.

The figures along tell the story. In 1984, one civil suit was filed for every 15 American. The size of our-of-court settlements and jury awards is unprecedented, reaching an average of $1.7 million during that same year, according to Forbes magazine. We do not yet have figures for 1985, but all reports indicate that they will exceed 1984.

This ominous increase in civil suit activity coincides with the end of a five-year cycle of underpriced insurance policies. As a result, insurance companies are opting out of the liability market or raising the rates to untenable levels.

The National Restaurant Association (NRA), in conjunction with Pennsylvania State University, held a symposium on "the crisis in product and service liability" on January 29, 1986. During that day-long forum those attending the session heard from representatives of the medical profession, the restaurant industry, city and county government and the manufacturing interest. These are just some of the industries and professions involved in this crisis. Day-care center operators, pharmaceutical companies, clergymen, midwives, real estate owners and many more have a story to tell in this regard. But the broad social implication of these stories would be the same: Because the danger of suit has become so great and the cost of liability insurance has risen so high, products and services are being withdrawn from the market or else prices are rising to cover the costs.

In other words, one consumer gets rich quick through a windfall decision, and the rest of the consuming public pays the price.

How does the restaurant industry in particular fit into this general situation? The details are similar, although there are some differences. Like other industries, restaurateurs are experiencing enormous increases in the cost of liability insurance. Liquor liability insurance is the most difficult coverage to obtain, after pollution risk. In some regions of the country, it is simply not available. Where it can be obtained, rates have skyrocketed.

For the past few years, NRA members have been reporting these increases. One operator in Washington, DC, saw his premium climb from $185 to $26,500 in one year. A michigan operator reported an increase from $6,700 to $30,520. A restaurateur in New Jersey reported that the cost of his total liability package rose from $25,00 to $92,000.

To get a better perspective on this situation, NRA engaged the Gallup organization to survey our industry and develop some average figures. The results are astounding. Sixty-nine percent of the respondents reported increases in liquor liability premium during the previous year, although 91 percent said they had never been named in a suit. The average increase was 110 percent; the average premium paid, $39,500.

The search for the causes of these startling increases takes us back through conditions within the insurance industry to the growing number of liquor liability suits brought against foodservice operations. The International Risk Management Institute estimates that there has been a 300 percent increase in such suits during the past year. And there has been an equally alarming increase in the size of the out-of-court settlements and jury awards that result from these suits.

Let me read you a short list of recent liquor liability awards: $1.7 million settlement against a convenience store in Florida; $3.9 million settlement against a Chinese restaurant in Massachusetts; $4.3 million verdict against a bar in Minnesota; $8.7 million verdict against a resort hotel in Pennsylvania; and $10 million verdict against a dinner club in Alabama.

These figures have been verified, but I first discovered them in a brochure promoting an American Bar Association seminar to assist lawyers in handling liquor liability cases.

The situation I have described so far parallels the circumstances faced by other industries. What makes our situation slightly different is that the court actions we face are third-party liability suits. That is, the restaurateur is not the actual cause of the damage, but he or she is held liable anyway. Today, 18 States have dram shop laws which hold the server of alcoholic beverages accountable for actions of the consumer. Seventeen States establish the same liability through common law precedent. And five States have both dram laws and common law liability.

There has been considerable public dispute as to whether a server should be held liable for the actions of the consumer. That is a question our society needs to address. Most restaurateurs will tell you that they are not responsible for the actions of a patron, but they have taken responsible actions anyway. Let me focus on that distinction for a minute.

Two years ago the National Restaurant Association introduced a three-part alcohol awareness program. The first part of this program involves consumer education. We committed ourselves to working with other public interest groups to warn the Americans about the dangers of drunk driving.

The second part of this program involves server training. We prepared a seminar for servers of alcoholic beverages. It covers questions such as how to recognize a guest who is becoming intoxicated, how to cut off service to such a guest and how to keep an intoxicated patron from driving. This seminar has now been offered in 37 States, and we are now revitalizing it and releasing it in a new form in the near future.

The third part of this program involved recommendations on in-house practices. NRA advised its members to eliminate all multiple-drink promotions which might be perceived as fostering over consumption. We advised them to introduce bar food, designated driver programs and alternative transportation programs.

The great majority of restaurateurs across this country have adopted our program. That is, they are taking responsible action in regard to drunk driving. But that does not mean that they are assuming responsibility for the actions of a patron who does become drunk despite their efforts.

Recently, the question of third-party liability has become more heated because of the proliferation of cases involving social host liability. In eighteen States, a host or hostess can now be held liable for the actions of an intoxicated guest. This new extension of liability has quite literally brought the plight of the bartender home to the average citizen. As a matter of fact, a recent AP poll showed that 72 percent of respondents believe that bartenders should not be held legally responsible for injuries caused by intoxicated patrons.

It is not my purpose to argue the case against third-party liability. I merely wish to point out that our society is by no means unanimous in holding one citizen responsible for the actions of another. Nevertheless, the number of third-party liability cases is escalating rapidly and awards ranging up into the millions are being regularly handed down.

Imagine for a moment the parties in court when such a case is tried. First there is the plaintiff. He or she may be the actual victim of an automobile accident, and may be maimed, scarred, or crippled. With coaching of a good attorney, the plaintiff will describe both the agony suffered and the long term effects of the accident.

Or the plaintiff may be a spouse, parent or child of a person killed in the accident. In this case, the plaintiff will testify to the loss of love and financial support, and to the anguish and grief suffered.

In either case, the plaintiff has and deserves our sympathy for needless suffering.

Then there is the drunk driver who is the direct cause of this suffering. He or she may be the victim of circumstance—a person who became intoxicated once and did something foolish. But more often, the drunk driver is an habitual offender—an individual with a drinking problem, adept at hiding his or her drunkenness. The drunk driver is probably remorseful and may even have sought treatment since the accident.

At any rate, the drunk driver rarely has the resources or insurance to cove the damages the plaintiff is demanding.

Then there is the restaurateur. The restaurateur learns that an employee may have served an intoxicated individual when this suit was filed—one or two years after the accident allegedly occurred. Given the turn-over rate, the bartenders or servers who may have been involved are no longer on staff. The restaurateur has no way of knowing if the drunk driver was in the restaurant on the occasion in question or if the driver was visibly intoxicated when served a drink.

Often, the restaurateur's only defense is habitual practice. He or she may testify about the precautions which are taken to prevent guests from becoming intoxicated and the training given to servers. But the plaintiff's attorneys will point out that habitual practice does not mean that precautions were taken during the occasion in question.

Lastly, there is the jury—people like you or me—who will identify with the plaintiff. This kind of accident is so irrational, so needless. It is impossible to put a price on the anguish which has just been described to them. They are less concerned about discerning actual culpability than about obtaining these damages. They may very well decide the case with regard to financial responsibility rather than moral responsibility. That means the party who has the most assets or insurance will pay the greatest part of the damages.

Given this very sad situation, you can be sure that the restaurateur is about to become the victim of a victim. The restaurateur will not get justice at the hands of the law.

And the situation can be worse. In regard to liquor liability, we are seeing far too many plaintiffs who are trying to profit from a minor grievance with the encouragement of an attorney working for a contingency fee.

And we are seeing far too many instances of "scatter gunning." That is, naming every licensed establishment within a specific radius of an alcohol-related accident and forcing the owners to prove that they did not serve the perpetrator during the day in question.

All of us believe in the citizen's right to redress through the courts. This principle is sacred. It is the heart of our liability law. What we object to are abuses of this right—the kind of abuses which I have just been describing.

To eliminate or at least reduce this kind of abuse, dram shop laws must be reformed in States where they exist. The National Restaurant Association would like to see the States introduce very specific changes:

First, dollar caps should be placed on the defendant's liability. Caps would assure a fair and equitable recovery for injured parties. At the same time, they lend the kind of predictability to awards that the insurance industry claims is necessary to curb unreasonable premium increases.

Second, liquor liability cases should be governed by the principle of "comparative negligence" and financial liability based solely on the defendant's percentage of responsibility for the accident. This would be a major attack on the "deep pocket" syndrome, which sees individuals named as defendants primarily because they have insurance and can pay a steep penalty.

Third, advance notice of a liquor liability case should be provided by plaintiffs. Currently, the defendants first notice of a suit comes when the suit is filed. That in turn usually occurs at the end of the limitation period, which can be two years, three years, or even longer. At that point, the defendant often finds it impossible to reconstruct events and present a strong defense.

Fourth, the time period for filing a suit under the statute of limitations must be reduced to a reasonable time frame.

These are just four changes we would like to see introduced. They would go a long way toward eliminating the abuses we are seeing.

But there is one even more basic change which is necessary if the crisis in service and product liability is to be ended. Our society must change its attitude toward civil suits. Our current attitude can be summed up in two sentences: "It doesn't matter if they are responsible. Their insurance will cover it." We have all heard that sentiment expressed in a thousand different ways. Americans take a very cynical attitude toward the right to redress. They seem to believe that any insured party is fair game. They cheer on the plaintiff, however frivolous or irrational his grievance. They applaud the windfall judgment as long as it goes against a well insured professional, corporation or institution.

It is this attitude which is responsible for the crisis in product and service liability.

We as a society tend to forget the obvious: All of us pay the penalty for every large court judgment. We pay it in higher insurance premiums. We pay it in loss of goods and services. We pay it in higher consumer prices. An over litigious society penalizes itself.

Social pressure is a powerful force which can modify behavior and modify the law. The time has come when our society must condemn abusers of our liability system. The alternative is an economy of scarcity and inflated prices, and none of us want that. We must work together to eliminate injustice and abuse in our liability system.

Thank you Mr. Chairman for this opportunity to share my comments with the committee.

STATEMENT OF THE MOLOKAI GENERAL HOSPITAL

Molokai General Hospital is a 30 bed, sole community hospital on the island of Molokai. The hospital provides a miriad of services to the island's 6,500 population. Services include: outpatient clinics, laboratory, radiology, surgery, inpatient care (16 acute beds, 14 long term care beds), emergency room services, family planning, family support services and midwifery program.

Molokai's economic base is primarily farming and tourism. Unemployment is high and approximately 50 percent of the population receives some form of governmental assistance. A little over 50 percent of the population is Hawaiian or part Hawaiian ancestry. We are a 30 minute airline flight away from Oahu where the major medical/trauma centers are located.

The hospital employs a general surgeon and contracts with three physicians for emergency room coverage. In addition, there is a private clinic on island consisting of five general practitioners. In December, 1984, this private clinic informed the hospital that they would not longer provide obstetrical care because they could not afford to pay the premium for professional liability insurance. They were told their premium would increase $18,000 for each physician if they provided OB care. There are approximately 80 births a year and the revenue from those deliveries would not cover the premium. This meant that all women would have to fly off island for OB care, prenatal and delivery of their child. The economic and social impact on families was significant. The impact to the community and the State, because many of the women are medicaid eligible, was also significant.

In response to this crisis, the hospital provided prenatal care through our outpatient clinic. An OB-GYN specialist flew in once a week from Oahu to provide this service. In addition, we provided classes on birthing and in particular, recognizing early signs of labor so women could be flown off island and we held numerous community meetings to inform the public.

In late August 1985, we recruited a certified nurse midwife and initiated a midwifery program. The nurse midwife is professionally backed by the general surgeon on island and an OB-GYN specialist on Oahu. Over 30 babies have been delivered to date.

In September 1985, however, the professional liability insurance problem impacted on hospitals. The only carrier in the State that insured hospitals decided to discontinue this service. A new company registered in the State and we were able to purchase insurance. Our 1984–1985 premium was approximately $30,000. Our 1985–1986 premium is $230,000. A staggering increase!

We do not have the population base nor service base to increase our revenue enough to cover this increase. In addition, reimbursing levels are being reduced. Our future has never been so uncertain.

The residents of the island need access to health care, even if to stabilize to be flown to Oahu for care.

We are not alone. The health care industry in our country is in jeopardy. The health of the country is in jeopardy.

STATE OF JOHN S. SATAGAJ, PRESIDENT, SMALL BUSINESS LEGISLATIVE COUNCIL

It is a pleasure to appear before this Subcommittee on behalf of the Small Business Legislative Council (SBLC). My name is John S. Satagaj and I am President of the organization. SBLC is a permanent coalition of approximately eighty-eight trade associations and our sole purpose is to represent the interests of small business in national policy matters. In order to be a member of the coalition, at least 70% of an association's membership dues must be derived from small firms. Our eighty-eight members represent over four million small businesses.

One of the striking features of SBLC is the fact we represent the breadth and depth of small business. As an assembly of associations, we represent a diverse range of interests which, of course, only reflects the fact small businesses dominate almost all sectors of the economy.

What makes SBLC work, and what makes our testimony so interesting, is the fact we do find many issues in common by nature of our common denominator of small business and I can say without hesitation, liability insurance is rapidly rising to the top of the list as a concern for all small firms, whatever the nature of their business, if it isn't already at the top of their list.

Within the small business community, we have seen several issues which coalesce the community and move them to action in unison. In the mid-70's tax rates were a major concern. In the late 70's, our concern was a voice for small business and we obtained a White House Conference and laws such as the Regulatory Flexibility Act. In the early 80's we started the battle for deficit reduction. In fact, over a longer term taxes and the deficit have been the traditional one-two on our priority list.

Liability insurance has pushed its way to the top of the pack and is pulling the community together. As you may know, we are currently in the midst of regional meetings leading up to a national White House Conference on Small Business this August here in Washington. At these local meetings, at least on per State, small business owners have an opportunity to vote on issues to shape an agenda for the national meeting. At the outset, certain issues categories were established and briefing papers were prepared. Insurance was not among these issues. Now some two dozen meetings later, insurance has its own session and a diverse range of recommendations have come forth from these sessions.

We, in the small business community, feel we are betwixt and between on this issue. Actually our problem is quite simple. Insurance is a cost of doing business. When the cost of insurance doubles, triples or quadruples, it takes a substantial bite out of the thin layer of income we call profit. If you have studied the profit and loss statement of any small firm, you know unexpected items such as this are what upset the apple cart and start the chain of events rolling which result in a business closing its doors. You never seem to catch up.

We have been deeply involved in identifying the source and extent of the problem since it surfaced in force last fall. We held a major conference on December 11th and heard presentations by the legal profession, the insurance industry and government. We have a second national conference scheduled for March 14-25.

Our member associations have been gathering data on their individual industries. Appended to this testimony are statements by five of our member groups. They represent a cross section of small businesses.

The surveys show a clear trend. Premiums are increasing at exponential rates. Fifty, seventy, and one hundred fifty percent increases are not unusual. Of greater concern, many firms are electing to go "bare" and forego any coverage. It is difficult to guess how long such a strategy will work. The results of these surveys demonstrate the depth of this crisis.

The individual stories bring the problem closer to home. A recent story in Newsday carried a summary of our members' stories and a copy is appended to my testimony. The litany of these anecdotes is long. One thing is certain, we can document, with hard data, the cost to stay in business.

We say we are betwixt and between because we don't believe we are a substantial contributor to the problem and really haven't heard anybody point the finger at us and say small businesses are careless. From the preliminary data we have seen, the "claims against" history for our member groups is very good.

Instead, we see several factors contributing to the problem. The first is the mind set of our society at this time. In a sense we have become a litigious society. These is always the feeling of "Well, I'll get mine, they can afford it." The ubiquitous "They" most likely translates into the insurance companies. Although the subject of insurance coverage is generally not discussed with juries, we can't help but wonder how many jurors could you find that didn't have the thought in the back of their minds that insurance will cover this case.

We believe tort reform is necessary. In SBLC, we have heard the trial lawyers present their case and we have listened to Assistant Attorney General Willard who heads up an interagency task force on tort reform. The size of awards, the contingency fee arrangement, the methodology of class action suits and probably, most importantly, the causes of action available to plaintiffs, all add to the problem. A plaintiff can sue just about anybody remotely involved in a "negligence" situation, and I use that term loosely, in search of a deep pocket. With a broad strict liability statute or case law, the burden of proof has been reduced substantially.

We are not saying throw the baby out with the bath water. To be sure, there are plenty of examples of wrongs made right only because of the system we have in place. We are suggesting, however, the process has outpaced the "economics" of justice. Society has to balance our individual protection against the need for a working economy. While we are not suggesting it is necessary it be an even balance, the system has pushed us too far in one direction.

We feel the insurance industry has played a role in the current crisis as well. Within our group we have heard testimony from this industry and again we come to the conclusion, the scale is not completely broken but is out of balance. Much of our concern is rooted in the belief the insurance industry might have taken its eye off the ball-the insurance business. Mergers, acquisitions, and investments have stretched some companies further than they would like to admit. These problems, coupled with an overreaction to isolated incidents have pushed premiums to the current level. We do not believe our claims record justifies the current premiums.

These are the problems we see, but where do the solutions lie? Generally, small business owners shudder at the thought of federal regulation. It is not a concept which sits well with them. Further, the two main contributors to the problem, the tort system and insurance regulation, have been tradition areas for State activity. As such we believe much of the reform could take place at the State level, but I stress the *could*.

This is not a national problem, and demands national attention. We believe we must explore the possibilities of Federal action both for tort reform and insurance regulation. As early as December we had called upon the President to set up a National Commission to develop recommendations for action. We urge Congress to do the same.

We have no magic solution and we know no one group should shoulder the blame for the current situation, but we do have a crisis.

We are willing to meet anytime to find solutions but there is little we can do without help. The sources of the problem are not under our direct control. We need your assistance, otherwise this problem will result in severe damage to the small business community.

Thank you for this opportunity.

AMERICAN SOCIETY OF INTERNAL MEDICINE POSITION PAPER ON THE PROFESSIONAL LIABILITY CRISIS

OVERVIEW OF THE PROBLEM

Medical professional liability is now as it was in the mid-1970s one of the single most important issues facing the medical community. While the crisis of 10 years ago was primarily one of "availability," physicians are now dealing with what is frequently described as a crisis of "affordability" and how it has affected access to as well as the cost and adequacy of quality medical care.

Internists and internal medicine subspecialists are being adversely affected by the crisis although not to the degree of other high risk specialties. Naturally many of the problems of the professional liability crisis are common to all physicians such as escalating professional liability premiums which add significantly to overhead expenses (in a time when many factors such as Medicare are forcing physicians to hold the line on fees) and the increasing practice of defensive medicine which adds an estimated $15 billion to the nation's overall cost of medical care.

While there are some groups such as the American Trial Lawyers Association who still question whether a crisis truly exists, the problem has been well-documented by others. According to the A.M. Best Company, independent analysts of the insurance industry, medical malpractice losses (including loss expenses incurred) have been higher than premiums earned since 1980. This loss ratio (claim losses plus loss expenses divided by premiums) was 150% in 1982 and 142% in 1983.[1] To some extent this loss as been ameliorated by investment income (interest generated by premiums until they are utilized) but even then claim losses and loss expenses have exceeded total income.

Any evaluation of how the insurance industry is performing in the medical professional liability line of business must not be limited to an examination of premiums to "paid losses" but must also include the millions of dollars spent by insurance companies in overhead, in adjusting losses, in defending physicians against claims without merit and paying company expenses and taxes.

The liability "crisis" is not limited just to medical practitioners. Rather the problem has affected a broad range of society. Skyrocketing awards have been occurring in product liability cases with their attendant costs being passed on the consumers. Some drug manufacturers have ceased producing childhood vaccines because it is virtually impossible to obtain the liability insurance necessary to stay in the market. The cost of professional liability insurance for architects and engineers is also increasing dramatically and, in some instances, the coverage is unavailable. Municipalities are having difficulty obtaining liability insurance and some are operating without it because they refuse to pay the premium that insurers are demanding or their insurers have dropped them. Further, there is evidence that many outside corporate directors are leaving their positions because their companies cannot maintain directors and officers liability insurance. If corporations maintain all-inside boards, questions obviously arise as to who is serving the shareholders.

Insurance companies are dramatically increasing rates because of their deteriorating financial position in underwriting medical professional liability insurance. Premiums vary dramatically from state to state. While average premiums for internists increased from approximately $2400 to $4400 from 1978 to 1983,[2] there are some areas of the country where annual premiums exceed $10,000.

While some argue that a few consistently negligent physicians have had a substantial impact on losses paid, the evidence shows that repeat offenders are not the problem. The fact is that most medical malpractice claims do not involve negligence. An estimated three out of four cases are ultimately settled in the provider's favor, but it is the high cost of defending claims that is also contributing to the dramatic rise in premiums.

The average physician risk of incurring a medical malpractice claim has increased nearly threefold since 1980. The incidence of claims filed against internists increased from 2.4 claims per 100 physicians prior to 1980 to 5.7 claims during the following five years.[3] An analysis of 1983 claims experienced by the 23 physician-owned medical professional liability insurance companies by the American Medical Assurance Company (AMACO), an American Medical Association subsidiary that provides reinsurance to the companies, shows that the incidence of claims has risen to 20.3 claims per 100 insured by physicians. In other words, one in five physicians will be sued this year.

Claims loss severity is also increasing at an alarming rate throughout the country. Jury Verdict Research of Solon, Ohio, reports that the average medical malpractice verdict (including million dollar verdicts) in 1975 was $220,018 but by 1984 the average had risen to $666,123. In 1975 there were 3 verdicts over $1 million while in 1984 there were 71 verdicts over $1 million.

The legal system does not deal with physicians fairly. Based on a study released in 1985 by the Rand Corporation's Institute for Civil Justice, the Institute found that jurors were much more sympathetic to plaintiffs injured in medical malpractice cases than plaintiffs with the same injury that occurred on property, at work or in connection with product liability cases. Malpractice awards were as much as five times higher than injury-on-property cases.

Some experts believe that the practice of defensive medicine (the ordering of additional tests in anticipation of a medical malpractice lawsuit) may have more of an impact on health care costs than professional liability premiums. Equally, there are experts who believe that defensive medicine is simply the increased care which the malpractice system is intended to encourage and that it is not possible to distinguish defensive medicine from the overutilization that results from the economic incentives inherent in fee-for-service medicine.[4] Some defensive medicine is described as simply good medical practice. Various surveys have shown, however, that defensive medicine unquestionably is on the rise.

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[1] Professional Liability in the '80s, Report 1. American Medical Association Special Task Force on Professional Liability and Insurance, October 1984, p. 8.

[2] What Legislators Need to Know About Medical Malpractice, Robert Pierce, senior research analyst, National Conference of State Legislators, based in part on presentations made at a national conference sponsored by The Urban Institute, February 1985, in Washington, D.C., entitled "Medical Malpractice: Can the Private Sector Find Relief?"

[3] AMA Socioeconomic Monitoring System (SMS) survey, 4th Quarter, 1984.

Indeed, surveys have shown that internists are keeping more detailed records, ordering more tests, obtaining more consultations, and are referring patients to other specialists more frequently.[5] In turn, the price of health insurance is increasing employee medical expenses thereby placing economic pressures on employers to implement cost-sharing features in their employee health benefit plans. Ultimately, the consumer of health care pays the price.

BYPRODUCTS OF THE PROBLEM

Although many experts believe that a good doctor-patient relationship will lead to fewer suits, the fear of a malpractice claim is causing some internists to maintain a more businesslike, "arms length" relationship with patients. No matter how good that rapport is between a patient and doctor, paranoia about malpractice and the fear of a lawsuit, especially for those who have been sued at least once, is affecting doctors' behavior around their patients.

Another area where the public as much as the provider suffers is with regard to the inefficiencies of the legal system itself. Patients who are injured because of their treatment deserve to be compensated promptly and fairly. The current legal system does not permit such a luxury because medical malpractice cases often take years to resolve. Fully one-third of all claims take more than two years to resolve, and even then, only 28 to 40 cents on the dollar (with some estimates as low as 20 to 25 cents) is returned to plaintiffs as compensation. The rest goes to attorneys and insurance companies to cover costs such as administration, claims evaluation and litigation costs.[6]

While the purpose of a lawsuit is to seek compensation for victims of malpractice and deter substandard care through the threat of legal action, there is one result that is often overlooked—the effect a lawsuit has on a physician from a personal standpoint. It has been shown that most physicians who are sued find that it is enormously disruptive to their personal and professional life. Many physicians who have been sued suffer from symptoms indicative of depression and stress which, in the long run, is likely to have an impact on the ability of the physician to deliver quality health care.[7] Medical liability lawsuits have also served as an incentive for some physicians to leave their practice or to retire at earlier ages resulting, in some cases, in the reduction in availability of care.

TORT REFORM

Tort reform is not the ultimate answer to the medical malpractice problem. To the contrary, there are some tort reforms that have done little to reduce medical liability costs and others that simply have not had the effect that was originally intended. There are a few reforms, however, that when carefully drafted, can go a long ways towards reducing medical liability costs. This, in turn, would benefit patients by lowering costs and by ensuring the availability of liability insurance and, hence, availability of health care services.

Moreover, there are some states when the professional liability problem is not as serious as in others. For this reason, individual states are in the best position to determine the need for legislative relief. The following reforms are among those which have been demonstrated to provide measurable claims savings and hence a reduction in the costs of the medical malpractice system:

Limitation on awards for non-economic damages (pain and suffering, mental anguish and loss of consortium).

Elimination of the collateral source rule to prevent double compensation to plaintiffs. (The collateral source rule prohibits introduction of evidence of information about compensation that a plaintiff may receive from sources other than the defendant; e.g., reimbursement from a health insurance policy or workers' compensation plan for medical expenses.)

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[4] "Evaluation of the Current Malpractice System," Patricia Danzon, presentation at the Urban Institute's national medical malpractice conference, "Medical Malpractice: Can the Private Sector Find Relief?" February 21-22, 1985.

[5] "What Doctors Are Doing About The Malpractice Threat," Physician's Management, September 1985, p. 69.

[6] Danzon, February 21-22, 1985, "Medical Malpractice: Can The Private Sector Find Relief?"

[7] "Sued and Nonused Physicians' Self-Reported Reactions to Malpractice Litigation," Sara C. Charles, MD, Jeffrey R. Wilbert, M.A., and Kevin J. Franke, M.A., American Journal of Psychiatry, 142:4, April 1985.

Periodic payment of damages to eliminate windfalls to the heirs of plaintiffs who die earlier than anticipated and to more appropriately compensate patients with lifetime disabilities.

Attorney fee regulation to ensure that reasonable compensation will go to injured plaintiffs without denying attorneys fair compensation. Earlier settlements will be encouraged (and tactics intended to delay settlements discouraged) by removing incentives to seek larger awards and therefore larger fees.

Elimination of punitive damages from professional liability lawsuits. Punitive damages are intended to punish the wrongdoer and this responsibility should be left to the state licensing boards, medical societies, hospital peer review systems and the criminal justice system.

STANDARDS OF CARE

Medical malpractice is negligent care by a health care provider that causes injury to a patient. To be awarded damages for medical malpractice, the plaintiff must prove that the legal standard of care has been breached, that there was injury and that the injury was caused by such breach. Establishing the standard of care in court is left to expert witnesses and the applicable standard is usually drawn from observation of customary practice. Eighteen states have laws establishing a medical standard of care.

One of the most difficult problems in medical malpractice cases is determining the standard of care (Should a local, state or national standard apply?). And in an era of increasingly sophisticated medical technology, when physicians cannot always agree on medical procedures, it is questionable whether a judge or lay jury can decide this issue.

Cost containment programs (Medicare's Prospective Payment System, for example) by their very nature, create pressures to restrict care which may affect its quality. Appropriate data collection and analysis should enable physicians to reach agreement on many treatment schedules (known as protocols) that would probably be helpful to some physicians who face these pressures. Any cost containment program, however, devoted to the delivery of high quality cost effective medical care should be constantly vigilant that quality of care is not compromised. A balance must be maintained in the cost-quality equation.

PEER REVIEW/RISK MANAGEMENT/DISCIPLINARY ACTION

State medical societies and national medical specialty societies as well as hospitals should be encouraged to implement peer review and risk management programs to ensure quality care. While there is no clear proof that risk management programs reduce the likelihood of a lawsuit, at least one medical speciality society has developed a risk management program which is believed to have been the main reason for a reduction in premiums for their particular group.

State licensing boards should be encouraged to investigate cases of medical negligence and take disciplinary action where appropriate. Insurance companies should be required to make certain data available to state agencies to aid them in their investigations. State medical examining boards often have difficulty identifying the physicians generating multiple claims involving actual negligence because claims in this category are often settled "quietly." Historically, these boards have been ineffective in revoking licenses of physicians who have demonstrated recurring aberrant practice because of, among other factors, the fear of being sued by physicians whom they seek to discipline and also because of limited resources. Efforts should be made to provide these state licensing boards with adequate resources to handle the caseload of investigations. Moreover, hospitals and state medical societies should not only report examples of flagrant and recurring negligence to state examining boards, but also patterns of care which indicate inappropriate practice or that the physician in question may be marginal.

CONSUMER EDUCATION/COMMUNICATION

The professional liability problem is not a reflection of the quality of medical care. Rather, the evidence suggests that quality has never been higher. Publicity about medical advances, however, has raised the public's expectations about medical outcomes. Consumers have come to expect perfect results every time treatment is rendered. Consumers need to understand that physicians are human and occasionally, because of events beyond their control, either an adverse result occurs, or the patient does not experience an outcome that is 100% perfect.

Consumers also need to be fully apprised of the fact that when they hear of the million dollar verdicts, it is the consumer who ultimately pays for them. As professional liability losses escalate, so do premium dollars and ultimately, fees to patients.

In an age of rapidly increasing medical technology, specialization and impersonal medical care, doctors also need to evaluate and strengthen their relationships with their patients. More effective communication between doctor and patient would enhance these relationships.

RECOMMENDATIONS

1. ASIM supports tort reform that encourages fair compensation to all deserving injured claimants or plaintiffs and prompt resolution of professional liability claims, and all personal injury claims.
2. ASIM believes that federal intervention may be necessary because of the magnitude of the problem, but also believes that states are in the best position to judge the seriousness of the problem and to implement appropriate legislative relief.
3. ASIM supports tort reform that accomplishes the following: limits awards for non-economic damages, eliminates punitive damages, eliminates the collateral source rule, and allows for periodic payment of damages. ASIM also supports tort reform which provides for attorney fee regulation in personal injury and medical malpractice cases.
4. ASIM supports the American Medical Association position regarding the concept of data collection and analysis to "correct inappropriate variations in treatment patterns and procedures."
5. ASIM encourages physicians' active involvement in peer review activities both at the medical society level and in hospital settings.
6. ASIM supports the development of risk management programs in hospitals as well as by specialty societies and state and local medical societies.
7. ASIM supports the strengthening of state licensing boards so they can more effectively investigate cases of medical negligence and take appropriate disciplinary action.
8. The public should be educated regarding expectations about medical outcomes and the effect the medical malpractice crisis is having on the cost, availability and quality of medical care.
9. Physicians should be encouraged to strengthen doctor-patient relationships to reaffirm the doctors' position as the patients' advocate.

TOWING AND RECOVERY ASSOCIATION OF AMERICA, INC.,
Washington, DC, March 4, 1986.

Hon. JOHN DANFORTH,
Senate Commerce, Science, and Transportation Committee, Hart Senate Office Building, Washington, DC.

DEAR CHAIRMAN DANFORTH: By far, the most immediate and serious problem confronting the nation's tow truck industry is escalating liability insurance costs. In the current premium renewal year, almost every tow truck company must face the reality of premium increases of 100 to 300 percent—if coverage is available at all. This devastating increase in operating costs is forcing many of these small businesses to make hard decisions concerning the extent of their insurance coverage, the pricing for their services, and—the toughest decision—whether or not to continue the business at all.

The vast majority of tow truck companies are small, family-oriented businesses which often generate only small profit margins. Of the overall cost of doing business, insurance premiums have always been a major overhead expense. With a great amount of road use and highway exposure, responsibility for customers and their valuable vehicles, and potential storage lot liability, the general nature of the towing industry lends itself to reliance upon insurance.

Now, the astronomical increase in insurance premiums is having a tremendously crippling effect on these businesses. It is not at all uncommon for the increase in 1985-86 insurance premiums to exceed the company's 1984-85 net profit. In order to just keep pace, tow truck owner-operators must consider several alternatives:

1. Reduction of coverage and/or increase in deductibles.—Obviously neither is an attractive option, but many tow truck operators are dropping collision coverage on their vehicles or accepting deductible amounts of $2500 to $5000 in order to afford the general liability and garage-keepers legal liability.

2. Raising rates dramatically.—Always a difficult alternative, increasing the price structure may decrease volume, thus further aggravating the tow operators dilemma. In addition, these price increases must ultimately be passed on to the consumer. Unaffordable towing service could have wide-ranging ramifications upon the nation's transportation system.

3. Operating without insurance.—Once considered impractical, if not impossible, many tow truck companies are now operating or considering operating with no insurance whatsoever. Indeed, the October, 1985 issue of Inc. magazine suggests that given the current insurance crisis, "going bare" may be a viable alternative for many businesses. Widespread adoption of a no-insurance practice by the nation's tow truck industry could have disastrous effects on consumer confidence.

It is important to note that many towing companies do not have this option. As a tow truck company involved in interstate towing or service to municipalities and various police agencies, many businesses are required to file certificates of insurance with the various authorities. The insurance requirements in those instances are often very high and inflexible, i.e., the requirements under the Motor Carrier Act of 1980.

4. Close out the business.—An unfortunate, but increasingly common alternative. Almost daily, frustrated businessmen are succumbing to the pressures of the insurance industry, are closing their doors and selling their equipment at a loss.

Reliable quantified data concerning loss ratios within the tow truck industry is unavailable at this time. T.R.A.A., working with various groups and insurance industry experts, is in the process of collecting such data. A recent extensive survey should yield results by year-end.

In the meantime, the towing industy is subjected to an ever-shrinking insurance market. In 1983, at least five insurance companies with an A+15 Best's Rating were writing tow truck insurance on a national level with many more offering policies on a regional or state-wide basis. Today, there is no A+15 national program available.

The situation is worsening. T.R.A.A. receives 10–15 calls daily inquiring about insurance, and the outlook by the insurance industry itself is bleak.

While Towing and Recovery Association of America believes it is premature at the present time to comment on proposed legislative responses, we support the investigative activity of this Committee. A full inquiry into loss ratios and loss reporting, rating, and premium pricing practices is long overdue.

The tow truck industry is a vital element of the surface transportation industry. The emergency nature of the business makes it an important link in the smooth operation of the transportation system in the United States. We must resolve the current insurance problem in order to assure that the motoring public is served by a properly-insured and reasonably-priced tow truck industry.

Sincerely yours,

MICHAEL MCGOVERN,
Executive Director.

NATIONAL COUNCIL OF FISHING VESSEL SAFETY AND INSURANCE,
Washington, DC, March 10, 1986.

Hon. JOHN C. DANFORTH,
Chairman, Senate Commerce Committee,
Washington, DC.

DEAR CHAIRMAN DANFORTH: The National Council of Fishing Vessel Safety and Insurance was formed in 1978 to coordinate the development of a national program aimed at reducing loss of life, vessels, equipment, and insurance costs for the United States fishing industry. With a membership composed of representatives of the U.S. commercial fishing industry, insurance companies, and others from the university and private sector, the Council has provided a forum to address questions of fishing vessel safety and insurance. Operating as a non-profit organization, the Council does not lobby on particular issues but rather serves as a resource for anyone interested in fishing safety and insurance matters. In response to the Senate Commerce Committee's request for information regarding the cost and availability of liability insurance, we would like to submit, for inclusion in the hearing record, the following comments which briefly describe the activities the Council has undertaken to help address the liability problems of the U.S. commercial fishing industry.

The National Council of Fishing Vessel Safety and Insurance has two fundamental goals: (1) improve vessel and crew safety, and (2) reduce the cost of insurance to the U.S. fishing industry. The Council publishes a quarterly newsletter which provides information on programs, proposals, acitivities and new developments in the area of vessel safety and insurance which is distributed to over 400 companies and individuals. The Council also serves as an information resource to the trade press and sponsors and participates in conferences across the United States.

With the support of federal funds awarded under the Saltonstall/Kennedy program, the Council has initiated various programs and studies to address the problem of fishing vessel safety and insurance. The following is a description of the major projects the Council is working on at this time.

This year, the Council will finish a study on the effects fishery management regulations can have on the safety of commercial fishing operations. Concern over the adverse impact fishery regulations have on the safety of vessels has led to changes in some U.S. fisheries. However, the Council hopes that this study will shed new light on the need to include vessel safety as a basic consideration in the development of all future fishery management plans.

The Council will also continue its work on establishing a nationwide data base on the types of injuries and accidents which occur on fishing vessels. In 1982 the Council started working with the Marine Index Bureau to develop a system for collecting and evaluating vessel accidents and crew casualty statistics. The American Institute of Marine Underwriters has assisted us in establishing a broad data base that can be used to define the nature and extent of casualties occurring in each fishery across the nation. We hope that with the Marine Underwriters continued support we will have a useful statistical basis available for industry use within the next few years.

The Council is also working on a project to assist various members of the fishing industry in locating their best fishing vessel insurance alternatives. Presently, through Council support, the Texas Shrimp Association is comparing various insurance options to find the best price and coverage for its members. The overall project will be conducted in five phases: (1) consideration of insurance alternatives, (2) prime alternative development, (3) presentation of prime insurance alternatives to industry, (4) implementation of best insurance alternative, and (5) post implementation analysis. It is anticipated that the Texas Shrimp Association will try to implement their best insurance alternative this summer. Each phase of this project represents milestones in the effort to overcome the insurance crisis within the shrimp industry.

On another front, the Council will be working during the first few months of 1986 to file its final report on alternative compensation systems for injured fishermen. This study, which was conducted by Professor Dennis Nixon from the University of Rhode Island, was designed to analyze the current method of compensating injured fishermen and compare those costs with several alternative compensation methods. In his final report, Professor Nixon proposes various changes in the current compensation system which he feels will help reduce overall cost of liability insurance for fishing vessel owners.

The Council's wide range of activities this year reflect a growing national concern with fishing vessel safety and insurance issues. It is the Council's goal to continue to address fishing vessel safety concerns and work in partnership with Federal, Congressional, university, and insurance industry efforts to help reduce insurance costs and increase insurance availability. The Council appreciates your interest in helping to solve the liability insurance crisis and we look forward to working closely with you in the future.

Sincerely,

JIM COSTAKES, *President.*

STATEMENT OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

The Associated General Contractors of America (AGC) with its 110 chapters nationwide represents more than 32,000 firms, including 8,400 of America's leading general contracting companies which are responsible for the employment of more than 3,400,000 individuals. These member contractors perform more than 80 percent of America's contract construction of commercial buildings, highways, industrial and municipal facilities as well as Federal construction projects.

OVERVIEW

One of the most serious problems facing general contractors today is the crisis relating to liability insurance, most particularly in the property/casualty area. Webster's defines "crisis" as "an unstable or crucial time or state of affairs." This definition accurately describes the current insurance marketplace. As the Committee well knows, general contractors are not alone in this crisis. Nearly every industry and business, even cities and municipalities and their subdivisions, are being affected. Nevertheless, while general contractors and the construction industry as a whole may not be alone in the problems they face in the liability insurance marketplace, certain aspects of the crisis have serious implications to general contractor operations. This statement will focus on several such implications which are unique to general contractors as a group, and which impact on Federal construction projects.

Many theories and allegations have been proffered as to the causes of the current situation. Some parties have even claimed there is no real "crisis". If a "crisis" is "an unstable time or state of affairs," you'll never convince a general contractor that there is no "crisis." The bleak reality is that regardless of what words you use to describe them, the problems exist and it does not appear they will disappear quickly. Every facet of liability insurance; premiums, limits of coverage, exclusions, types of policy forms being used, is in a state of instability and uncertainty.

EFFECTS ON CONSTRUCTION INDUSTRY

Most general contractors recognize that the insurance market is cyclical, having experienced the down-cycles in the past. While there were warnings of some increases in property/casualty premiums, few, if any contractors had reason to anticipate either the suddeness or extent of such increases. Horror stories of increases of 300%, 500%, even 1000% and more are not isolated situations. Nor are cancellations and non-renewal notices, either of entire policies or particular coverages and limits. General contractors faced with such increases or needing to obtain new coverage, have found little relief and more limited sources for property/casualty insurance.

As devastating as the premium increases have been, two other problems are of equal significance and seriousness. Limits of coverage have been substantially reduced, even while the total premiums being paid have markedly escalated. Even more significant is the lack of coverage at any price in such areas as asbestos and hazardous waste removal.

Major increases in costs over a short time period have a particularly adverse affect on a general contractor's business. Once a project is bid and a contract executed, cost increases are absorbed by the contractor. It is not at all uncommon for the period of a construction project, from bid to completion, to extend beyond the expiration date of the contractor's insurance policy in effect at the inception of a project. Drastic increases in insurance premiums, as has been the case during the past year, play havoc not only with individual project budgets, but with a contractor's overall financial planning. There is simply no way to recover such cost increases on work still in progress, and which may continue for some time, when a contractor's insurance policies come up for renewal.

Most construction contracts contain provisions specifying the types and amounts of insurance coverage a contractor is obligated to maintain. Once a project is under contract, a contractor does not have the prerogative of reducing his limits of coverage to offset increases in premiums. This dilemma has been compounded by the fact that in the current market coverage limits, regardless of cost, have been significantly reduced. In many cases contractors are finding it extremely difficult, and even impossible, to obtain the coverage limits specified in their contracts. Finding himself in this position, a contractor must either try to negotiate the required limits downward or be in breach of contract. Negotiation is not always possible since the owner, who originally specified the limits of coverage, has an interest in the amount of coverage the contractor carries. Being in breach of contract carries very obvious implications and is simply not practical.

This situation is not limited to private sector construction contracts. Public contracts, including those for Federal projects, are equally affected. In fact, because of the very structured nature of Federal procurement and contracting procedures, there is much less flexibility, and therefore less likelihood, of a negotiation of insurance coverage limits on a Federal project. Accordingly, the potential for contractors being in breach of contract and the resultant disruption of construction projects is greatly increased in the public sector.

ASBESTOS COVERAGE

As serious as the effects of increased premiums and coverage limits are, they pale in the face of the increasing problem of coverages for certain types of work being unavailable at any price. Of particular concern in this regard, is coverage for exposure to asbestos. It has been estimated that over the next three years $26 billion of asbestos removal work will be required to alleviate concerns over potential asbestos exposure in our nation's buildings, including public buildings and schools. Asbestos abatement work, however, much like hazardous waste clean up, has ceased to be an approachable market for contractors because of the virtual disappearance of liability coverage; a disappearance that will mean many planned asbestos removal projects may never be implemented.

The seriousness of the asbestos exposure problem cannot be minimized. The environmental Protection Agency is now proposing to ban the use of asbestos materials in construction products. However, while this will address the problem as far as future construction is concerned, it does nothing for the problem as it relates to existing buildings. Many buildings constructed more than 15 years ago, are likely to contain some asbestos. Whether it be during specific removal operations or simple remodeling efforts, the asbestos exposure problem is virtually inevitable. Therefore, the unavailability of insurance for asbestos work will not only curtail asbestos removal efforts, remodeling of existing buildings will be severly disrupted if the contractor encounters asbestos.

In such a situation, the contractor may be forced to suspend work because his general liability policy will most likely exclude coverage for asbestos related injuries. The new Insurance Services Office Commercial General Liability Form contains such an exclusion, as well as an exclusion for coverage of asbestos related work performed at governmental direction or request. Under many public contracts, including Federal government contracts, the contractor could be directed to continue work and remove the asbestos. Confronted with this situation, a contractor would be in the proverbial catch-22 position. If he proceeded with the asbestos removal, he would be doing so without insurance coverage. If he refused, he could be in breach of contract.

Clearly the problem of asbestos exposure must be resolved. Otherwise, the much needed asbestos removal projects will not proceed. Moreover, there will be a significant disruption of construction activities, including Federal government construction programs. The root of the problem is clearly the liability associated with asbestos work and the unavailability of adequate insurance to mitigate and protect against this liability. AGC's suggestion is that provisions, similar to those in current Superfund legislation which either exempt or indemnify hazardous waste contractors from certain liabilities be implemented to extend to asbestos abatement work and exposure to asbestos encountered in building remodeling work. Such provisions should: Differentiate between the liability of cleanup contractors and that of responsible parties; establish a single standard applicable in all 50 states for third party contractor liability; hold contractors responsible only for their own negligence; provide indemnification to cover negligence to the extent it is not covered by insurance; and developed guidelines specifying what constitutes negligence.

In addition, AGC strongly suggests that provisions be included in Federal procurement and other government contract regulations which preclude a contracting officer or agency from ordering a contractor to proceed when asbestos or asbestos suspected material is encountered. Such provisions should allow a contractor the right to suspend work in such situations until the asbestos material is removed.

CLAIMS-MADE COVERAGE

One of the most significant changes taking place as an outgrowth of the insurance crisis is the shift by the insurance industry, both primary carriers and reinsurers, from occurrence based coverage to claims-made coverage in comprehensive general liability policies. Claims made coverage differs from occurrance based coverage in that the factor determining coverage is the date the claim is made rather than the date the insured event took place. The problem with claims made coverage is that if the coverage is ever cancelled, the entire period of time which had been covered by claims-made insurance becomes uninsured. Similarly, if the retroactive date, the date claims made coverage is effective, is not the same as the expiration date of a contractor's former occurrance based policy, or if the retroactive date is ever changed, a contractor would be uninsured for events which may have occurred between the expiration date of his occurrence based policy and the retroactive date of the claims made policy.

AGC opposes any effort by the insurance industry to offer comprehensive general liability coverage only on a claims-made basis. Given the one-sided nature of such insurance, there is a great possibility that claims-made policies could be cancelled, or the retroactive date changed, leaving construction owners, contractors and the public alike virtually uninsured against future claims. The consequences of such a result could be catastrophic. The only remedy offered by the insurance industry is the purchase of "extended reporting period" coverage at rates even more exorbinate than the primary coverage. This is simply not an acceptable remedy for the detrimental implications of claims made policies.

NEED FOR TORT REFORM

Whether it be the primary cause of the current crisis, as the insurance industry claims, or simply a contributory factory adding to an already chaotic situation, the breakdown of the civil justice system needs to be addressed. Serious problems exist in our court system, Federal as well as State. Costs of litigation, the length of the litigation process and the size of judgments awarded have all increased beyond a reasonable or acceptable level. Reforms to the civil justice system are needed to restore order to the system and bring it back to the purpose for which it was established; the just and reasonable compensation of victims of accidents or injury for the economic loss they have incurred.

Efforts are underway in many states under the catch all title of "Tort Reform" to address the problems within our court system. AGC suggests that Congress undertake a study to produce appropriate model civil justice reform measures which will help produce a greater consistency, certainty and reasonableness within the judicial process throughout our nation's court systems.

U.S. SENATE,
COMMITTEE ON COMMERCE, SCIENCE, AND TRANSPORTATION,
Washington, DC, March 10, 1986.

Mr. ALBERT J. BEER,
FCAS, MAAA, Vice President, Tillinghast, Nelson & Warren, Inc., New York, NY.

DEAR MR. BEER: As Chairman of the Senate Committee on Commerce, Science, and Transportation, I would like to thank you for appearing before the Committee and presenting testimony on the availability and cost of liability insurance. I assure you that the views you have expressed will be given serious consideration by the Committee in its efforts to shape an appropriate federal response to the problem.

Enclosed are additional questions for the record submitted by Senator Larry Pressler. Your prompt response to these questions will be appreciated by the Committee.

Sincerely,

JOHN C. DANFORTH,
Chairman.

Question 1. In your publication entitled "The Cost of the U.S. Tort System," it was pointed out that Tort System costs have increased in "real terms" by a factor of nearly nine times since 1950. How did you define "Tort System costs" and are you able to distinguish them from other costs incurred by the insurance industry?

Answer. In "The Cost of US Tort System", the tort system costs are basically defined as gross loss costs and expenses. For the insurance system that would include calendar year incurred losses plus expenses such as administrative and sales costs, as well as defense costs.

In the time series developed since 1950, the tort system costs included self-insurance and captives. For those the costs were incurred losses and loss adjustment expenses as well as other administrative expenses.

Question 2. Do you feel a closed claims study of the several distressed lines of commercial liability insurance would demontrate the relationship between the tort laws complained of by the insurance industry, and the current price and scarcity of insurance?

Do you know of any other way to develop this information?

Answer. A well-structured closed claim study might be able to distinguish the anecdotes from the true results with regard to alleged abuses of the tort system. It may be very difficult to judge what settlements would have been under the traditional tort law interpretations, e.g. contributory negligence, vs. the current interpretations such as joint and several liability or absolute liability. However, quantitative attempts could be made to indicate how much erosion there has been in the tort system.

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